Intermediate
Course: Paper 1

# ADVANCED ACCOUNTING

## (New Scheme of Education and Training)

**Part 1**

*By*

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*Dedicated*

*To My Parents*

**Late Sh. SATPAL SHARMA**

**Smt. JANKI DEVI**

# Syllabus

## PAPER 1: ADVANCED ACCOUNTING

*(One paper – Three hours – 100 Marks)*

**Objective:**

To acquire the ability to apply specific accounting standards and legislations to different transactions and events and in preparation and presentation of financial statements of various business entities.

**Contents:**

1. Process of formulation of Accounting Standards including Indian Accounting Standards (IFRS converged standards) and IFRSs; Convergence vs Adoption; Objective and Concepts of carve outs.
2. Framework for Preparation and Presentation of Financial Statements (as per Accounting Standards).
3. (i) Applicability of Accounting Standards to various entities

   (ii) Application of Accounting Standards:

   AS 1: Disclosure of Accounting Policies

   AS 2: Valuation of Inventories

   AS 3: Cash Flow Statements

   AS 4: Contingencies and Events Occurring After the Balance Sheet Date

   AS 5: Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

   AS 7: Construction Contracts

   AS 9: Revenue Recognition

   AS 10: Property, Plant and Equipment

   AS 11: The Effects of Changes in Foreign Exchange Rates

   AS 12: Accounting for Government Grants

   AS 13: Accounting for Investments

   AS14: Accounting for Amalgamations (excluding inter- company holdings)

   AS 15: Employee Benefits

   AS 16: Borrowing Costs

   AS 17: Segment Reporting

   AS 18: Related Party Disclosures

   AS 19: Leases

AS 20: Earnings Per Share

AS21: Consolidated Financial Statements of single subsidiaries (excluding problems involving acquisition of Interest in Subsidiary at Different Dates, Cross holding, Disposal of a Subsidiary and Foreign Subsidiaries).

AS 22: Accounting for Taxes on Income

AS 23: Accounting for Investment in Associates in Consolidated Financial Statements

AS 24: Discontinuing Operations

AS 25: Interim Financial Reporting

AS 26: Intangible Assets

AS 27: Financial Reporting of Interests in Joint Ventures

AS 28: Impairment of Assets

AS 29: Provisions, Contingent Liabilities and Contingent Assets

4. Company Accounts

   (i) Schedule III to the Companies Act, 2013 (Division I)

   (ii) Preparation of financial statements – Statement of Profit and Loss, Balance Sheet and Cash Flow Statement

   (iii) Buy back of securities

   (iv) Accounting for reconstruction of companies.

5. Accounting for Branches including foreign branches.

**Note:** If either new Accounting Standards (AS), Announcements and Limited Revisions to AS are issued or the earlier ones are withdrawn or new AS, Announcements and Limited Revisions to AS are issued in place of existing AS, Announcements and Limited Revisions to AS, the syllabus will accordingly include/exclude such new developments in the place of the existing ones with effect from the date to be notified by the Institute.

# Contents

CHAPTER 1

# Introduction to Accounting Standards

## Theoretical Questions

**Question 1**

Explain the objective of "Accounting Standards" in brief. State the advantages of setting Accounting Standards.

(*Study Material*)

**Answer**

Accounting Standards are the written policy documents issued by Government relating to various aspects of measurement, treatment, presentation and disclosure of accounting transactions and events.

Following are the objectives of Accounting Standards:

(a) Accounting Standards harmonize the diverse accounting policies and practices followed by different companies in India.

(b) Accounting Standards facilitates the preparation of financial statements and make them comparable.

(c) Accounting Standards give a sense of faith and reliability to the users.

The main advantage of setting accounting standards are as follows:

(a) Accounting Standards makes the financial statements of different companies comparable which helps investors in decision making.

(b) Accounting Standards prevent any misleading accounting treatment.

(c) Accounting Standards prevent manipulation of data by the management.

**Question 2**

Briefly explain the process of issuance of Indian Accounting Standards.

(*Study Material*)

**Answer**

Due to the recent stream of overseas acquisitions by Indian companies, there is need for adoption of high quality standards to convince foreign enterprises about the financial standing as also the disclosure and governance standards of Indian acquirers.

The Government of India in consultation with the ICAI decided to converge and not to adopt IFRSs issued by the IASB. The decision of convergence rather than adoption was taken after the detailed analysis of IFRSs requirements and extensive discussion with various stakeholders.

The ICAI has worked towards convergence of global accounting standards by considering the application of IFRS in Indian corporate environment. Recognising the growing need of full convergence of Ind AS with IFRS, ICAI constituted a Task Force to examine various issues involved.

Ind AS are issued by the Central Government of India under the supervision and control of ASB of ICAI and in consultation with NFRA. NFRA recommends these standards to the MCA and MCA has to spell out the accounting standards applicable for companies in India.

## Question 3

Explain the significance of emergence of IFRS as Global Standards.

(*Study Material*)

**Answer**

Global Standards facilitate cross border flow of money, global listing in different bourses and comparability of financial statements. Global Standards improve the ability of investors to compare investments on a global basis and thus lowers their risk of errors of judgment. It facilitates accounting and reporting for companies with global operations and eliminates some costly requirements say reinstatement of financial statements.

## Question 4

What do you mean by Carve outs/ins in Ind AS? Explain.

(*Study Material*)

**Answer**

Certain changes have been made in Ind AS considering the economic environment of the country, which is different as compared to the economic environment presumed to be in existence by IFRS. These differences are due to differences in economic conditions prevailing in India. These differences which are in deviation to the accounting principles and practices stated in IFRS, are commonly known as 'Carve-outs'. Additional guidance given in Ind AS over and above what is given in IFRS, is termed as 'Carve in'.

# Test Your Knowledge
# MCQs

**1.** Accounting Standards for non-corporate entities in India are issued by

(a) Central Govt.

(b) State Govt.

(c) Institute of Chartered Accountants of India.

**Answer:** (c)

**2.** Accounting Standards

(a) Harmonise accounting policies and eliminate the non-comparability of financial statements.

(b) Improve the reliability of financial statements.

(c) Both (a) and (b).

**Answer:** (c)

**3.** It is essential to standardize the accounting principles and policies in order to ensure

(a) Transparency.

(b) Consistency.

(c) Both (a) and (b).

**Answer:** (c)

**4.** Which committee is responsible for approval of accounting standards and their modification for the purpose of applicability to companies?

(a) NFRA.

(b) MCA.

(c) Central Government Advisory Committee.

**Answer:** (b)

**5.** Global Standards facilitate

(a) Cross border flow of money.

(b) Comparability of financial statements.

(c) Both (a) and (b).

**Answer:** (c)

**6.** Additional guidance given in Ind AS over and above what is given in IFRS are called

(a) Carve-outs.

(b) Carve-ins.

(c) Carve clarifications.

**Answer:** (b)

**7.** IASB stands for

(a) International Accounting Standards Bureau

(b) International Advisory Standards Board

(c) International Accounting Standard Board.

**Answer:** (c)

**8.** IFRS stands for

(a) International Financial Reporting System

(b) International Finance Reporting Standard

(c) International Financial Reporting Standard.

**Answer:** (c)

**9.** Phase I of Ind AS was applicable to:

(a) All listed companies in India or outside India

(b) Companies with turnover INR 500 crores or more

(c) Companies with net worth INR 500 crores or more.

**Answer:** (c)

# QUESTION BANK

## Question 5

"Accounting Standards standardize diverse accounting policies with a view to eliminate the non-comparability of financial statements and improve the reliability of financial statements." Discuss and explain the benefits of Accounting Standards.

(*November 2018*) (*4 Marks*)

**Answer:**

Accounting Standards standardize diverse accounting policies with a view to eliminate the non-comparability of financial statements and improve the reliability of financial statements. Accounting Standards provide a set of standard accounting policies, valuation norms and disclosure requirements. Accounting standards aim at improving the quality of financial reporting by promoting comparability, consistency and transparency, in the interests of users of financial statements.

The following are the benefits of Accounting Standards:

(i) ***Standardization of alternative accounting treatments:*** Accounting Standards reduce to a reasonable extent confusing variations in the accounting treatment followed for the purpose of preparation of financial statements.

(ii) ***Requirements for additional disclosures:*** There are certain areas where important is not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.

(iii) ***Comparability of financial statements:*** The application of accounting standards would facilitate comparison of financial statements of different companies situated in India and facilitate comparison, to a limited extent, of financial statements of companies situated in different parts of the world. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in Accounting Standards adopted in different countries.

## Question 6

"Accounting Standards standardize diverse accounting policies with a view to eliminate the non- comparability of financial statements and improve the reliability of financial statements." Discuss and explain the benefits of Accounting Standards.

(*MTP, November, 2021*) (*5 Marks*)

**Answer**

Accounting Standards standardize diverse accounting policies with a view to eliminate the non- comparability of financial statements and improve the reliability of financial statements. Accounting Standards provide a set of standard accounting policies, valuation norms and disclosure requirements. Accounting standards aim at improving the quality of financial reporting by promoting comparability, consistency and transparency, in the interests of users of financial statements.

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## Question 7

What is meant by 'Measurement'? What are the bases of measurement of Elements of Financial Statements? Explain in brief.

(*RTP, November 2021*)

**Answer**

Measurement is the process of determining money value at which an element can be recognized in the balance sheet or statement of profit and loss. The framework recognizes four alternative measurement bases for the purpose. These bases can be explained as:

| | |
|---|---|
| Historical cost | This is the Acquisition price. According to this, assets are recorded at an amount of cash and cash equivalent paid or the fair value of the assets at time of acquisition. |
| Current Cost | Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently. |
| Realisable (Settlement) Value | For assets, amount currently realizable on sale of the asset in an orderly disposal. For liabilities, this is the undiscounted amount expected to be paid on settlement of liability in the normal course of business. |
| Present Value | Assets are carried at present value of future net cash flows generated by the concerned assets in the normal course of business. Liabilities are carried at present value of future net cash flows that are expected to be required to settle the liability in the normal course of business. |

In preparation of financial statements, all or any of the measurement basis can be used in varying combinations to assign money values to financial items.

CHAPTER 2

# Framework for Preparation and Presentation of Financial Statements

## Question 1

*Balance sheet of a trader on 31st March, 20X1 is given below:*

| *Liabilities* | *₹* | *Assets* | *₹* |
|---|---|---|---|
| *Capital* | *60,000* | *Property, Plant and Equipment* | *65,000* |
| *Profit and Loss Account* | *25,000* | *Stock* | *30,000* |
| *10% Loan* | *35,000* | *Trade receivables* | *20,000* |
| *Trade payables* | *10,000* | *Deferred costs* | *10,000* |
| | | *Bank* | *5,000* |
| | *1,30,000* | | *1,30,000* |

***Additional information**:*

*(a) The remaining life of Property, Plant and Equipment is 5 years. The pattern of use of the asset is even. The net realisable value of Property, Plant and Equipment on 31.03.X2 was ₹ 60,000.*

*(b) The trader's purchases and sales in 20X1-X2 amounted to ₹ 4 lakh and ₹ 4.5 lakh respectively.*

*(c) The cost and net realisable value of stock on 31.03.X2 were ₹ 32,000 and ₹ 40,000 respectively.*

*(d) Expenses (including interest on 10% Loan of ₹ 3,500 for the year) amounted to ₹ 14,900.*

*(e) Deferred cost is amortised equally over 4 years.*

*(f) Trade receivables on 31.03.X2 is ₹ 25,000, of which ₹ 2,000 is doubtful. Collection of another ₹ 4,000 depends on successful re-installation of certain product supplied to the customer.*

*(g) Closing trade payable is ₹ 12,000, which is likely to be settled at 5% discount.*

*(h) Cash balance on 31.03.X2 is ₹ 37,100.*

*(i) There is an early repayment penalty for the loan ₹ 2,500.*

*You are required to prepare Profit and Loss Accounts and Balance Sheets of the trader in both cases (i) assuming going concern (ii) not assuming going concern.* (*Study Material*)

**Answer**

***Profit and Loss Account for the year ended 31st March, 20X2***

| | *Case (i)* | *Case (ii)* | | *Case (i)* | *Case (ii)* |
|---|---|---|---|---|---|
| | *₹* | *₹* | | *₹* | *₹* |
| To Opening Stock | 30,000 | 30,000 | By Sales | 4,50,000 | 4,50,000 |
| To Purchases | 4,00,000 | 4,00,000 | By Closing Stock | 32,000 | 40,000 |
| To Expenses | 14,900 | 14,900 | By Trade payables | - | 600 |
| To Depreciation | 13,000 | 5,000 | | | |
| To Provision for doubtful debts | 2,000 | 6,000 | | | |
| To Deferred cost | 2,500 | 10,000 | | | |
| To Loan penalty | - | 2,500 | | | |
| To Net Profit (b.f.) | 19,600 | 22,200 | | | |
| | 4,82,000 | 4,90,600 | | 4,82,000 | 4,90,600 |

***Balance Sheet as at 31st March, 20X2***

| ***Liabilities*** | ***Case (i)*** ***₹*** | ***Case (ii)*** ***₹*** | ***Assets*** | ***Case (i)*** ***₹*** | ***Case (ii)*** ***₹*** |
|---|---|---|---|---|---|
| Capital | 60,000 | 60,000 | Property, Plant and Equipment | 52,000 | 60,000 |
| Profit & Loss A/c | 44,600 | 47,200 | Stock | 32,000 | 40,000 |
| 10% Loan | 35,000 | 37,500 | Trade receivables (less provision) | 23,000 | 19,000 |
| Trade payables | 12,000 | 11,400 | Deferred costs | 7,500 | Nil |
| | | | Bank | 37,100 | 37,100 |
| | 1,51,600 | 1,56,100 | | 1,51,600 | 1,56,100 |

## Question 2

*A Ltd. has entered into a binding agreement with P Ltd. to buy a custom-made machine for ₹ 40,000. At the end of 20X1-X2, before delivery of the machine, A Ltd. had to change its method of production. The new method will not require the machine ordered and it will be scrapped after delivery. The expected scrap value is nil.* [Covered in AS-10]

**Answer**

*A liability is recognised when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, A Ltd. should recognise a liability of ₹ 40,000 to P Ltd.*

*When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognised as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognised as an expense. The accounting entry is suggested below:*

| | | *₹* | *₹* |
|---|---|---|---|
| *Loss on change in production Method*<br>*To P Ltd.*<br>*(Loss due to change in production method)* | *Dr.* | *40,000* | <br>*40,000* |
| *Profit and loss A/c*<br>*To Loss on change in production method*<br>*(loss transferred to profit and loss account)* | *Dr.* | *40,000* | <br>*40,000* |

## Question 3

*Suppose at the beginning of an accounting period, aggregate values of assets, liabilities and equity of a trader are ₹ 5 lakh, ₹ 2 lakh and ₹ 3 lakh respectively.*

*Also suppose that the trader had the following transactions during the accounting period.*

*(a) Introduced capital ₹ 20,000.*

*(b) Earned income from investment ₹ 8,000.*

*(c) A liability of ₹ 31,000 was finally settled on payment of ₹ 30,000.*

***Answer***

*Balance sheets of the trader after each transaction are shown below:*

| ***Transactions*** | ***Assets*** ***₹ lakh*** | ***–*** | ***Liabilities*** ***₹ lakh*** | ***=*** | ***Equity*** ***₹ lakh*** |
|---|---|---|---|---|---|
| *Opening* | *5.00* | *–* | *2.00* | *=* | *3.00* |
| *(a) Capital introduced* | *5.20* | *–* | *2.00* | *=* | *3.20* |
| *(b) Income from investments* | *5.28* | *–* | *2.00* | *=* | *3.28* |
| *(c) Settlement of liability* | *4.98* | *–* | *1.69* | *=* | *3.29* |

*The example given above explains the definition of income. The equity increased by₹ 29,000 during the accounting period, due to (i) Capital introduction₹ 20,000 and*

*(ii) Income earned ₹ 9,000 (Income from investment + Discount earned). Incomes therefore result in increase in equity without introduction of capital.*

*Also note that income earned is accompanied by either increase of asset (Cash received as investment income) or by decrease of liability (Discount earned).*

## Question 4

*Continuing with the above question 3 given earlier, suppose the trader had the following further transactions during the period:*

*(a) Wages paid ₹ 2,000.*

*(b) Rent outstanding ₹ 1,000.*

*(c) Drawings ₹ 4,000.*

(*Study Material*)

**Answer**

***Balance sheets of the trader after each transaction are shown below:***

| *Transactions* | *Assets ₹ lakh* | – | *Liabilities ₹ lakh* | = | *Equity ₹ lakh* |
|---|---|---|---|---|---|
| *Opening* | *5.00* | – | *2.00* | = | *3.00* |
| *(a) Capital introduced* | *5.20* | – | *2.00* | = | *3.20* |
| *(b) Income from investments* | *5.28* | – | *2.00* | = | *3.28* |
| *(c) Settlement of liability* | *4.98* | – | *1.69* | = | *3.29* |
| *(d) Wages paid* | *4.96* | – | *1.69* | = | *3.27* |
| *(e) Rent Outstanding* | *4.96* | – | *1.70* | = | *3.26* |
| *(f) Drawings* | *4.92* | – | *1.70* | = | *3.22* |

*The example given above explains the definition of expense. The equity decreased by ₹ 7,000 from ₹ 3.29 lakh to ₹ 3.22 lakh due to (i) Drawings ₹ 4,000 and (ii) Expenses incurred ₹ 3,000 (Wages paid + Rent).*

*Expenses therefore result in decrease of equity without drawings. Also note that expenses incurred is accompanied by either decrease of asset (Cash paid for wages) or by increase in liability (Rent outstanding).*

## Question 5

*A trader commenced business on 01/01/20X1 with ₹ 12,000 represented by 6,000 units of a certain product at ₹ 2 per unit. During the year 20X1 he sold these units at ₹ 3 per unit and had withdrawn ₹ 6,000. Assume that the price of the product at the end of year is ₹ 2.50 per unit. The specific price index applicable to the product is 125.*

*Current cost of opening stock = (₹ 12,000/100) x 125 = 6,000 x ₹ 2.50 = ₹ 15,000*

*Current cost of closing cash = ₹ 12,000 (₹ 18,000 – ₹ 6,000)*

*Opening equity at closing current costs = ₹ 15,000*

*Closing equity at closing current costs = ₹ 12,000*

*Retained Profit = ₹ 12,000 – ₹ 15,000 = (-) ₹ 3,000*

*The negative retained profit indicates that the trader has failed to maintain his capital. The available fund of ₹ 12,000 is not sufficient to buy 6,000 units again at increased price of ₹ 2.50 per unit. The drawings should have been restricted to ₹ 3,000 (₹ 6,000 – ₹ 3,000). Had the trader withdrawn ₹ 3,000 instead of ₹ 6,000, he would have left with ₹15,000, the fund required to buy 6,000 units at ₹ 2.50 per unit.*

*You are required to compute the Capital maintenance under all three bases ie. (i) Historical costs, (ii) Current purchasing power and (iii) Physical capital maintenance.*

(*Study Material*)

**Answer**

***Financial Capital Maintenance at historical costs***

| | ₹ | ₹ |
|---|---|---|
| Closing capital (At historical cost) | | 12,000 |
| Less: Capital to be maintained | | |
| Opening capital (At historical cost) | 12,000 | |
| Introduction (At historical cost) | Nil | (12,000) |
| Retained profit | | Nil |

***Financial Capital Maintenance at current purchasing power***

| | ₹ | ₹ |
|---|---|---|
| Closing capital (At closing price) | | 12,000 |
| Less: Capital to be maintained | | |
| Opening capital (At closing price) | 14,400 | |
| Introduction (At closing price) | Nil | (14,400) |
| Retained profit/(loss) | | (2,400) |

***Physical Capital Maintenance***

| | ₹ | ₹ |
|---|---|---|
| Closing capital (At current cost) ( 4,800 units) | | 12,000 |
| Less: Capital to be maintained | | |
| Opening capital (At current cost) (6,000 units) | 15,000 | |
| Introduction (At current cost) | Nil | (15,000) |
| Loss resulting in non-maintenances of capital | | (3,000) |

# Theoretical Questions

## Question 6

What are the qualitative characteristics of the financial statements which improve the usefulness of the information furnished therein?

(*Study Material*)

**Answer**

The qualitative characteristics are attributes that improve the usefulness of information provided in financial statements. Understandability; Relevance; Reliability; Comparability are the qualitative characteristics of financial statements. For details, refer para 7 of the chapter.

## Question 7

"One of the characteristics of financial statements is neutrality"- Do you agree with this statement?

(*Study Material*)

**Answer**

Yes, one of the characteristics of financial statements is neutrality. To be reliable, the information contained in financial statement must be neutral, that is free from bias. Financial Statements are not neutral if by the selection or presentation of information, the focus of analysis could shift from one area of business to another thereby arriving at a totally different conclusion on the business results.

# Practical Questions

## Question 8

Mohan started a business on 1st April 20X1 with ₹ 12,00,000 represented by 60,000 units of ₹ 20 each. During the financial year ending on 31st March, 20X2, he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Mohan in the year 20X1 -X2 if Financial Capital is maintained at historical cost.

(*Study Material*)

**Answer**

| *Particulars* | *Financial Capital Maintenance at Historical Cost (₹)* |
|---|---|
| Closing equity(₹ 30 x 60,000 units) | 18,00,000 represented by cash |
| Opening equity | 60,000 units x ₹ 20 = 12,00,000 |
| Permissible drawings to keep Capital intact | 6,00,000 (18,00,000 – 12,00,000) |

## Question 9

Opening Balance Sheet of Mr. A is showing the aggregate value of assets, liabilities and equity ₹ 8 lakh, ₹ 3 lakh and ₹ 5 lakh respectively. During accounting period, Mr. A has the following transactions:

(1) Earned 10% dividend on 2,000 equity shares held of ₹ 100 each

(2) Paid ₹ 50,000 to creditors for settlement of ₹ 70,000

(3) Rent of the premises is outstanding ₹ 10,000

(4) Mr. A withdrew ₹ 9,000 for his personal use.

You are required to show the effect of above transactions on Balance Sheet in the form of Assets - Liabilities = Equity after each transaction.

(*Study Material*)

**Answer**

**Effects of each transaction on Balance sheet of the trader is shown below:**

| *Transactions* | *Assets ₹ lakh* | – | *Liabilities ₹ lakh* | = | *Equity ₹ lakh* |
|---|---|---|---|---|---|
| Opening | 8.00 | – | 3.00 | = | 5.00 |
| (1) Dividend earned | 8.20 | – | 3.00 | = | 5.20 |
| (2) Settlement of Creditors | 7.70 | - | 2.30 | = | 5.40 |
| (3) Rent Outstanding | 7.70 | – | 2.40 | = | 5.30 |
| (4) Drawings | 7.61 | – | 2.40 | = | 5.21 |

## Question 10

Balance Sheet of Anurag Trading Co. on 31st March, 20X1 is given below:

| Liabilities | Amount (₹) | Assets | Amount (₹) |
|---|---|---|---|
| Capital | 50,000 | Property, Plant and Equipment | 69,000 |
| Profit and Loss A/c | 22,000 | Stock in Trade | 36,000 |
| 10% Loan | 43,000 | Trade Receivables | 10,000 |
| Trade Payables | 18,000 | Deferred Expenditure | 15,000 |
| | | Bank | 3,000 |
| | 1,33,000 | | 1,33,000 |

Additional Information:

(i) Remaining life of Property, Plant and Equipment is 5 years with even use. The net realisable value of Property, Plant and Equipment as on 31st March, 20X2 was ₹ 64,000.

(ii) Firm's sales and purchases for the year 20X1-X2 amounted to ₹ 5 lacs and₹ 4.50 lacs respectively.

(iii) The cost and net realisable value of the stock were ₹ 34,000 and ₹ 38,000 respectively.

(iv) General Expenses for the year 20X1-X2 were ₹16,500.

(v) Deferred Expenditure is normally amortised equally over 4 years starting fromF.Y. 20X0-X1 i.e. ₹5,000 per year.

(vi) Out of trade receivables worth ₹10,000, collection of ₹4,000 depends on successful re-design of certain product already supplied to the customer.

(vii) Closing trade payable is ₹10,000, which is likely to be settled at 95%.

(viii) There is pre-payment penalty of ₹2,000 for Bank loan outstanding.

Prepare Profit & loss Account for the year ended 31st March, 20X2 by assuming it is not a Going Concern.

(*Study Material*)

**Answer**

**Profit and Loss Account of Anurag Trading Co. for the year ended 31st March, 20X2**
**(Assuming business is not a going concern)**

| | ₹ | | ₹ |
|---|---|---|---|
| To Opening Stock | 36,000 | By Sales | 5,00,000 |
| To Purchases | 4,50,000 | By Trade payables | 500 |
| To General expenses | 16,500 | By Closing Stock | 38,000 |
| To Depreciation (69,000-64,000) | 5,000 | | |
| To Provision for doubtful debts | 4,000 | | |
| To Deferred expenditure | 15,000 | | |
| To Loan penalty | 2,000 | | |
| To Net Profit (b.f.) | 10,000 | | |
| | 5,38,500 | | 5,38,500 |

# Test Your Knowledge
## MCQs

**1.** The 'going concern' concept assumes that
  (a) The business can continue in operational existence for the foreseeable future.
  (b) The business cannot continue in operational existence for the foreseeable future.
  (c) The business is continuing to be profitable.

**Answer:** (a)

**2.** Two principal qualitative characteristics of financial statements are
  (a) Understandability and materiality
  (b) Relevance and reliability
  (c) Relevance and materiality

**Answer:** (b)

**3.** All of the following are components of financial statements except
  (a) Balance sheet
  (b) Statement of Profit and loss
  (c) Human responsibility report

**Answer:** (c)

**4.** An accounting policy can be changed if the change is required
  (a) By statute or accounting standard
  (b) For more appropriate presentation of financial statements
  (c) Both (a) and (b)

**Answer:** (c)

**5.** Value of equity may change due to

(a) Contribution from or Distribution to equity participants

(b) Income earned/expenses incurred

(c) Both (a) and (b)

**Answer:** (c)

**6.** An item that meets the definition of an element of financial statements should be recognised in the financial statements if:

(a) It is probable that any future economic benefit associated with the item will flow to the enterprise

(b) Item has a cost or value that can be measured with reliability

(c) Both (a) and (b)

**Answer:** (c)

**7.** A machine was acquired in exchange of an old machine and ₹ 20,000 paid in cash. The carrying amount of old machine was ₹ 2,00,000 whereas its fair value was ₹ 1,50,000 on the date of exchange. The historical cost of the new machine will be taken as

(a) ₹ 2,00,000

(b) ₹ 1,70,000

(c) ₹ 2,20,000

**Answer:** (b)

**8.** Which of the assumption is not considered as fundamental accounting assumption?

(a) Going Concern

(b) Accrual

(c) Reliability.

**Answer:** (c)

**9.** Liabilities are recorded at the undiscounted amount of cash expected to be paid on settlement of liability in the normal course of business under:

(a) Present value.

(b) Realizable value.

**(c)** Current cost.

**Answer:** (b)

# QUESTION BANK

## Question 11

Summarised Balance Sheet of Cloth Trader as on 31.03.2017 is given below:

| Liabilities | Amount (₹) | Assets | Amount (₹) |
|---|---|---|---|
| Proprietor's Capital | 3,00,000 | Fixed Assets | 3,60,000 |
| Profit & Loss Account | 1,25,000 | Closing Stock | 1,50,000 |
| 10% Loan Account | 2,10,000 | Sundry Debtors | 1,00,000 |
| Sundry Creditors | 50,000 | Deferred Expenses | 50,000 |
| | | Cash & Bank | 25,000 |
| | **6,85,000** | | **6,85,000** |

Additional Information is as follows:

(1) The remaining life of fixed assets is 8 years. The pattern of use of the asset is even. The net realizable value of fixed assets on 31.03.2018 was ₹ 3,215,000.

(2) Purchases and Sales in 2017-18 amounted to ₹ 22,50,000 and ₹ 27,50,000 respectively.

(3) The cost and net realizable value of stock on 31.03.2018 were ₹ 2,00,000 and 2,50,000 respectively.

(4) Expenses for the year amounted to ₹ 78,000.

(5) Deferred Expenses are amortized equally over 5 years.

(6) Sundry Debtors on 31.03.2018 are ₹ 1,50,000 of which ₹ 5,000 is doubtful. Collection of another ₹ 25,000 depends on successfully re-installation of certain product supplied to the customer.

(7) Closing Sundry Creditors are ₹ 75,000, likely to be settled at 10% discount.

(8) Cash balance as on 31.03.2018 is ₹ 4,22,000.

(9) There is an early repayment penalty for the loan of ₹ 25,000.

You are required to prepare:

(Not assuming going concern)

(1) Profit & Loss Account for the year 201718.

(2) Balance Sheet as on 31st March, 2018.

(*May 2019*) (*5 Marks*)

**Answer**

**Profit and Loss Account for the year ended 2017-18(not assuming going concern)**

| ***Particulars*** | ***Amount*** | ***Particulars*** | ***Amount*** |
|---|---|---|---|
| | ₹ | | ₹ |
| To Opening Stock | 1,50,000 | By Sales | 27,50,000 |
| To Purchases | 22,50,000 | By Closing Stock | 2,50,000 |
| To Expenses* | 78,000 | By Trade payables | 7,500 |
| To Depreciation | 35,000 | | |
| To Provision for doubtful debts | 30,000 | | |
| To Deferred cost | 50,000 | | |
| To Loan penalty | 25,000 | | |
| To Net Profit (b.f.) | 3,89,500 | | |
| | 30,07,500 | | 30,07,500 |

**Balance Sheet as at 31st March, 2018 (not assuming going concern)**

| *Liabilities* | *Amount* ₹ | *Assets* | *Amount* ₹ |
|---|---|---|---|
| Capital | 3,00,000 | Fixed Assets | 3,25,000 |
| Profit & Loss A/c | 5,14,500 | Stock | 2,50,000 |
| 10% Loan | 2,35,000 | Trade receivables (less provision) | 1,20,000 |
| Trade payables | 67,500 | Deferred costs | Nil |
| | | Bank | 4,22,000 |
| | 11,17,000 | | 11,17,000 |

*Assumed that ₹ 78,000 includes interest on 10% loan amount for the year.

## Similar Question

### Question 11A

Summarised Balance Sheet of Cloth Trader as on 31.03.2020 is given below:

| Equity and Liabilities | Amount (₹) | Assets | Amount (₹) |
|---|---|---|---|
| Proprietor's Capital | 3,00,000 | Fixed Assets | 3,60,000 |
| Profit & Loss Account | 1,25,000 | Closing Stock | 1,50,000 |
| 10% Loan Account | 2,10,000 | Trade receivables | 1,00,000 |
| Trade payables | 50,000 | Deferred Expenses | 50,000 |
| | | Cash & Bank | 25,000 |
| | 6,85,000 | | 6,85,000 |

Additional Information is as follows:

(1) The remaining life of fixed assets is 8 years. The pattern of use of the asset is even. The net realizable value of fixed assets on 31.03.2021 was ₹ 3,25,000.

(2) Purchases and Sales in 2020-21 amounted to ₹ 22,50,000 and ₹ 27,50,000 respectively.

(3) The cost and net realizable value of stock on 31.03.2021 were ₹ 2,00,000 and ₹ 2,50,000 respectively.

(4) Expenses for the year amounted to ₹ 78,000 which includes interest on 10% loan amount for the year.

(5) Deferred Expenses are amortized equally over 5 years.

(6) Trade receivables on 31.03.2021 are ₹ 1,50,000 of which ₹ 5,000 is doubtful. Collection of another ₹ 25,000 depends on successful re-installation of certain product supplied to the customer;

(7) Closing trade payables are ₹ 75,000, likely to be settled at 10% discount.

(8) Cash balance as on 31.03.2021 is ₹ 4,22,000.

(9) There is an early repayment penalty for the loan of ₹ 25,000.

You are required to prepare: (Not assuming going concern)

(1) Profit & Loss Account for the year 2020-21.

(2) Balance Sheet as on 31st March, 2021.

*(RTP May, 2022)*

**Answer**

**Books of Cloth Trader**

**Profit and Loss Account for the year ended 2020-21 (not assuming going concern)**

| Particulars | Amount | Particulars | Amount |
|---|---|---|---|
| | ₹ | | ₹ |
| To Opening Stock | 1,50,000 | By Sales | 27,50,000 |
| To Purchases | 22,50,000 | By Closing Stock | 2,50,000 |
| To Expenses | 78,000 | By Trade payables | 7,500 |
| To Depreciation | 35,000 | | |
| To Provision for doubtful debts | 30,000 | | |
| To Deferred cost | 50,000 | | |
| To Loan penalty | 25,000 | | |
| To Net Profit (b.f.) | 3,89,500 | | |
| | 30,07,500 | | 30,07,500 |

**Balance Sheet as at 31st March, 2021 (not assuming going concern)**

| *Liabilities* | *Amount* ₹ | *Assets* | *Amount* ₹ |
|---|---|---|---|
| Capital | 3,00,000 | Fixed Assets | 3,25,000 |
| Profit & Loss A/c | 5,14,500 | Stock | 2,50,000 |
| 10% Loan | 2,35,000 | Trade receivables (less provision) | 1,20,000 |
| Trade payables | 67,500 | Deferred costs | Nil |
| | | Bank | 4,22,000 |
| | 11,17,000 | | 11,17,000 |

### Question 12

"One of the characteristic of the financial statement is neutrality." Do you agree with this statement? Explain in brief.

(*November 2018*) (*4 Marks*)

**Answer:**

Yes, one of the characteristics of financial statements is neutrality. To be reliable, the information contained in financial statement must be neutral, that is free from bias.

Financial Statements are not neutral if by the selection or presentation of information, the focus of analysis could shift from one area of business to another thereby arriving at a totally different conclusion based on the business results. Information contained in the financial statements must be free from bias. It should reflect a balanced view of the financial position of the company without attempting to present them in biased manner. Financial statements cannot be prepared with the purpose to influence certain division, i.e. they must be neutral.

## Question 13

Briefly explain the elements of financial statements,

(*May 2018*) (*4 Marks*)

**Answer:**

**Elements of Financial Statements**

| | |
|---|---|
| Asset | Resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise |
| Liability | Present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow of a resource embodying economic benefits. |
| Equity | Residual interest in the assets of an enterprise after deducting all its liabilities |
| Income/gain | Increase in economic benefits during the accounting period in the form of inflows or enhancement of assets or decreases in liabilities that result in increase in equity other than those relating to contributions from equity participants |
| Expense/loss | Decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decrease in equity other than those relating to distributions to equity participants |

## Question 14

With regard to financial statements name any four.

(1) Users
(2) Qualitative characteristics
(3) Elements

(*RTP May 2019*)

**Answer:**

**(1) Users of financial statements:**
Investors, Employees, Lenders, Supplies/Creditors, Customers, Government & Public

**(2) Qualitative Characteristics of Financial Statements:**
Understandability, Relevance, Comparability, Reliability & Faithful Representation

**(3) Elements of Financial Statements:**
Asset, Liability, Equity, Income/Gain and Expense/Loss

## Question 15

Explain in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the Balance Sheet or Statement of Profit and Loss.

(*RTP November 2018*)

**Answer:**

The Framework for Recognition and Presentation of Financial statements recognizes four alternative measurement bases for the purpose of determining the value at which an element can be recognized in the balance sheet or statement of profit and loss. These bases are: (i) Historical Cost; (ii) Current cost (iii) Realizable (Settlement) Value and (iv) Present Value.

A brief explanation of each measurement basis is as follows:

1. *Historical Cost*: Historical cost means acquisition price. According to this, assets are recorded at an amount of cash or cash equivalent paid or the fair value of the asset at the time of acquisition. Liabilities are generally recorded at the amount of proceeds received in exchange for the obligation.
2. *Current Cost*: Current cost gives an alternative measurement basis. Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
3. *Realizable (Settlement) Value*: As per realizable value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in an orderly disposal. Liabilities are carried at their settlement values; i.e. the undiscounted amount of cash or cash equivalents paid to satisfy the liabilities in the normal course of business.
4. *Present Value*: Under present value convention, assets are carried at present value of future net cash flows generated by the concerned assets in the normal course of business. Liabilities under this convention are carried at present value of future net cash flows that are expected to be required to settle the liability in the normal course of business.

## Question 16

Mohan started a business on 1st April 2017 with ₹ 12,00,000 represented by 60,000 units of ₹ 20 each. During the financial year ending on 31st March, 2018, he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Mohan in the year 2017-18 if Financial Capital is maintained at historical cost.

(*RTP November 2018*)

**Answer:**

| Particulars | Financial Capital Maintenance at Historical Cost (₹) |
|---|---|
| Closing equity (₹ 30 × 60,000 units) | 18,00,000 represented by cash |
| Opening equity | 60,000 units × ₹ 20 = 12,00,000 |
| Permissible drawings to keep Capital intact | 6,00,000 (18,00,000 -12,00,000) |

Thus, in order to maintain the capital intact Mohan can withdraw ₹ 6,00,000 as the maximum amount

## Question 17

Explain main elements of Financial Statements.

(*RTP May 2018*)

**Answer:**

**Elements of Financial Statements**

The Framework for preparation and Presentation of financial statements classifies items of financial statements can be classified in five broad groups depending on their economic characteristics: Asset, Liability, Equity, Income/Gain and Expense/Loss.

| | |
|---|---|
| **Asset** | Resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise |
| **Liability** | Present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow of a resource embodying economic benefits. |
| **Equity** | Residual interest in the assets of an enterprise after deducting all its liabilities. |
| **Income/gain** | Increase in economic benefits during the accounting period in the form of inflows or enhancement of assets or decreases in liabilities that result in increase in equity other than those relating to contributions from equity participants |
| **Expense/loss** | Decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decrease in equity other than those relating to distributions to equity participants. |

## Question 18

Explain in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the Balance Sheet or Statement of Profit and Loss.

(*MTP March 2019*) (*5 Marks*)

**Answer:**

The Framework for Recognition and Presentation of Financial statements recognises four alternative measurement bases for the purpose of determining the value at which an element can be recognized in the balance sheet or statement of profit and loss. These bases are: (i) Historical Cost; (ii) Current cost (iii) Realisable (Settlement) Value and (iv) Present Value.

A brief explanation of each measurement basis is as follows:

1. **Historical Cost**: Historical cost means acquisition price. According to this, assets are recorded at an amount of cash or cash equivalent paid or the fair value of the asset at the time of acquisition. Liabilities are generally recorded at the amount of proceeds received in exchange for the obligation.
2. **Current Cost:** Current cost gives an alternative measurement basis. Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
3. **Realisable (Settlement) Value:** As per realisable value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in *an orderly disposal*. Liabilities are carried at their settlement values; i.e. the undiscounted amount of cash or cash equivalents paid to satisfy the liabilities in the normal course of business.
4. **Present Value**: Under present value convention, assets are carried at present value of future net cash flows generated by the concerned assets in the normal course of business. Liabilities under this convention are carried at present value of future net cash flows that are expected to be required to settle the liability in the normal course of business.

## Question 19

Explain in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the Balance Sheet or Statement of Profit and Loss.

(*MTP April 2019*) (*5 Marks*)

**Answer:**

The Framework for Recognition and Presentation of Financial statements recognises four alternative measurement bases for the purpose of determining the value at which an element can be recognized in the balance sheet or statement of profit and loss. These bases are: (i) Historical Cost; (ii) Current cost (iii) Realisable (Settlement) Value and (iv) Present Value.

A brief explanation of each measurement basis is as follows:

1. **Historical Cost**: Historical cost means acquisition price. According to this, assets are recorded at an amount of cash or cash equivalent paid or the fair value of the asset at the time of acquisition. Liabilities are generally recorded at the amount of proceeds received in exchange for the obligation.
2. **Current Cost:** Current cost gives an alternative measurement basis. Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
3. **Realisable (Settlement) Value:** As per realisable value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in *an orderly disposal*. Liabilities are carried at their settlement values; i.e. the undiscounted amount of cash or cash equivalents paid to satisfy the liabilities in the normal course of business.
4. **Present Value**: Under present value convention, assets are carried at present value of future net cash flows generated by the concerned assets in the normal course of business. Liabilities under this convention are carried at present value of future net cash flows that are expected to be required to settle the liability in the normal course of business.

## Question 20

"One of the characteristics of financial statements is neutrality". Do you agree with this statement? Comment.

(*MTP March 2018*) (*5 Marks*)

**Answer**

Yes, one of the characteristics of financial statements is neutrality. To be reliable, the information contained in financial statement must be neutral, that is free from bias.

Financial Statements are not neutral if by the selection or presentation of information, the focus of analysis could shift from one area of business to another thereby arriving at a totally different conclusion on the business results.

For example, if the assets of a company primarily consist of trade receivables and insurance claims and the financial statements do not specify that the insurance claims have been lying unrealized for a number of years or that a few key trade receivables have not given balance confirmation certificates, an erroneous conclusion may be drawn on the liquidity of the company. Financial statements are said to depict the true and fair view of the business of the organization by virtue of neutrality.

## Question 21

Aman started a business on 1st April 20X1 with ₹24,00,000 represented by 1,20,000 units of ₹20 each. During the financial year ending on 31st March, 20X2, he sold the entire stock for ₹30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Aman in the year 20X1-X2 if Financial Capital is maintained at historical cost.

(*RTP November 2019*)

**Answer**

| ***Particulars*** | ***Financial Capital Maintenance at Historical Cost (₹)*** |
|---|---|
| Closing equity<br>(₹ 30 x 1,20,000 units) | 36,00,000 represented by cash |
| Opening equity | 1,20,000 units x ₹ 20 = 24,00,000 |
| Permissible drawings to keep Capital intact | 12,00,000 (36,00,000 – 24,00,000) |

## Question 22

Explain in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the financial statements.

(*MTP April, 2018*) (*5 Marks*)

**Answer:**

The Framework for Recognition and Presentation of Financial statements recognises four alternative measurement bases for the purpose of determining the value at which an element can be recognized in the balance sheet or statement of profit and loss. These bases are: (i) Historical Cost; (ii) Current cost (iii) Realisable (Settlement) Value and (iv) Present Value.

A brief explanation of each measurement basis is as follows:

1. **Historical Cost**: Historical cost means acquisition price. According to this, assets are recorded at an amount of cash or cash equivalent paid or the fair value of the asset at the time of acquisition. Liabilities are generally recorded at the amount of proceeds received in exchange for the obligation.
2. **Current Cost**: Current cost gives an alternative measurement basis. Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
3. **Realisable (Settlement) Value**: As per realisable value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in an orderly disposal. Liabilities are carried at their settlement values; i.e. the undiscounted amount of cash or cash equivalents paid to satisfy the liabilities in the normal course of business.
4. **Present Value**: Under present value convention, assets are carried at present value of future net cash flows generated by the concerned assets in the normal course of business. Liabilities under this convention are carried at present value of future net cash flows that are expected to be required to settle the liability in the normal course of business.

## Question 23

With regard to financial statements name any four.

(i) Users
(ii) Qualitative characteristics
(iii) Elements

(*RTP, November 2020*)

**Answer**

**(i) Users of financial statements:**
Investors, Employees, Lenders, Supplies/Creditors, Customers, Government & Public

**(ii) Qualitative Characteristics of Financial Statements:**
Understandability, Relevance, Comparability, Reliability & Faithful Representation

**(iii) Elements of Financial Statements:**
Asset, Liability, Equity, Income/Gain and Expense/Loss

## Question 24

What are the issues, with which Accounting Standards deal?

(*RTP, November 2020*)

**Answer**

Accounting Standards deal with the issues of (i) Recognition of events and transactions in the financial statements, (ii) Measurement of these transactions and events, (iii) Presentation of these transactions and events in the financial statements in a manner that is meaningful and understandable to the reader, and (iv) Disclosure requirements.

## Question 25

Explain how financial capital is maintained at historical cost?

Kishore started a business on 1st April, 2019 with ₹ 15,00,000 represented by 75,000 units of ₹20 each. During the financial year ending on 31st March, 2020, he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Kishore in the year 2019-20 if Financial Capital is maintained at historical cost. (*Suggested January 2021, 5 marks*)

**Answer**

Financial capital maintenance at historical cost: Under this convention, opening and closing assets are stated at respective historical costs to ascertain opening and closing equity. If retained profit is greater than or equals to zero, the capital is said to be maintained at historical costs. This means the business will have enough funds to replace its assets at historical costs. This is quite right as long as prices do not rise.

Maximum amount withdrawn by Kishore in year 2019-20 if financial capital is maintained at historical cost

| Particulars | Financial Capital Maintenance at Historical Cost (₹) |
|---|---|
| Closing equity (₹ 30 x 75,000 units) | 22,50,000 represented by cash |
| Opening equity | 75,000 units x ₹ 20 = 15,00,000 |
| Permissible drawings to keep Capital intact | 7,50,000 (22,50,000 – 15,00,000) |

Thus ₹ 7,50,000 is the maximum amount that can be withdrawn by Kishore in year 2019-20 if Financial capital is maintained at historical cost.

## Question 26

Explain in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the Balance Sheet or Statement of Profit and Loss.

(*MTP March, 2021*) (*4 Marks*)

**Answer**

The Framework for Recognition and Presentation of Financial statements recognizes four alternative measurement bases for the purpose of determining the value at which an element can be recognized in the balance sheet or statement of profit and loss. These bases are: (i) Historical Cost; (ii) Current cost (iii) Realizable (Settlement) Value and (iv) Present Value.

A brief explanation of each measurement basis is as follows:

1. **Historical Cost**: Historical cost means acquisition price. According to this, assets are recorded at an amount of cash or cash equivalent paid or the fair value of the asset at the time of acquisition. Liabilities are generally recorded at the amount of proceeds received in exchange for the obligation.
2. **Current Cost:** Current cost gives an alternative measurement basis. Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
3. **Realisable (Settlement) Value:** As per realizable value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in *an orderly disposal*. Liabilities are carried at their settlement values; i.e. the undiscounted amount of cash or cash equivalents paid to satisfy the liabilities in the normal course of business.
4. **Present Value**: Under present value convention, assets are carried at present value of future net cash flows generated by the concerned assets in the normal course of business. Liabilities under this convention are carried at present value of future net cash flows that are expected to be required to settle the liability in the normal course of business.

## Question 27

Opening Balance Sheet of Mr. A is showing the aggregate value of assets, liabilities and equity ₹ 8 lakh, ₹ 3 lakh and ₹ 5 lakh respectively. During accounting period, Mr. A has the following transactions:

(1) Earned 10% dividend on 2,000 equity shares held of ₹ 100 each
(2) Paid ₹ 50,000 to creditors for settlement of ₹ 70,000
(3) Rent of the premises is outstanding ₹ 10,000
(4) Mr. A withdrew ₹ 9,000 for his personal use.

You are required to show the effect of above transactions on Balance Sheet in the form of Assets - Liabilities = Equity after each transaction.

(*MTP April, 2021*) (*5 Marks*)

**Answer**

**Effects of each transaction on Balance sheet of the trader is shown below:**

| ***Transactions*** | ***Assets ₹ lakh*** | **–** | ***Liabilities ₹ lakh*** | **=** | ***Equity ₹ lakh*** |
|---|---|---|---|---|---|
| Opening | 8.00 | – | 3.00 | = | 5.00 |
| (1) Dividend earned | 8.20 | – | 3.00 | = | 5.20 |
| (2) Settlement of Creditors | 7.70 | - | 2.30 | = | 5.40 |
| (3) Rent Outstanding | 7.70 | – | 2.40 | = | 5.30 |
| (4) Drawings | 7.61 | – | 2.40 | = | 5.21 |

## Question 28

A trader commenced business on April 1, 2020 with ₹1,20,000, represented by 6000 units of a certain product at ₹20 per unit. During the year 2020-21 he sold these units at ₹30 per unit and had withdrawn ₹60,000. The price of the product at the end of financial year was ₹25 per unit. Compute retained profit of the trader under the concept of physical capital maintenance at current cost. Also state, whether answer would be different if the trader had not withdrawn any amount.

(*Question Paper, July 2021*) (*4 Marks*)

**Answer**

**Physical Capital Maintenance at Current Cost**

In the given case, the specific price index applicable to the product is 125 (25/20X100). Current cost of opening stock = (₹1, 20,000 / 100) x 125 Or 6,000 units x ₹ 25 = ₹ 1, 50,000

Current cost of closing cash = ₹ 1, 20,000 (₹ 1, 80,000 – ₹ 60,000) Opening equity at closing current costs = ₹ 1, 50,000

Closing equity at closing current costs = ₹ 1, 20,000 Retained Profit = ₹ 1, 20,000 – ₹ 1, 50,000 = (-) ₹ 30,000

The negative retained profit indicates that the trader has failed to maintain his capital. The available fund of ₹ 1, 20,000 is not sufficient to buy 6,000 units again at increased price of ₹ 25 per unit. The drawings should have been restricted to ₹30,000 (₹ 60,000 – ₹ 30,000).

**If the trader had not withdrawn any amount, then the answer would have been as below:**

Current cost of opening stock = ₹ 1, 80,000

Opening equity at closing current costs = ₹ 1, 50,000 Retained Profit = ₹ 1, 80,000 – ₹ 1, 50,000 = ₹ 30,000

If the trader had not withdrawn any amount, then the retained profit would have been ₹ 30,000.

## Question 29

(a) With regard to financial statements, name any five qualitative characteristics and elements.

(b) Aman started a business on 1st April 2020 with ₹ 24,00,000 represented by 1,20,000 units of ₹ 20 each. During the financial year ending on 31st March, 2021, he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Aman in the year 2020-21 if Financial Capital is maintained at historical cost. (*RTP May, 2021*)

**Answer**

**(a) (i) Qualitative Characteristics of Financial Statements:**

Understandability, Relevance, Comparability, Reliability & Faithful Representation

**(ii) Elements of Financial Statements:**

Asset, Liability, Equity, Income/Gain and Expense/Loss

**(b)**

| ***Particulars*** | ***Financial Capital Maintenance at Historical Cost (₹)*** |
|---|---|
| Closing equity (₹ 30 x 1,20,000 units*)* | 36,00,000 represented by cash |
| Opening equity | 1,20,000 units x ₹ 20 = 24,00,000 |
| Permissible drawings to keep Capital intact | 12,00,000 (36,00,000 – 24,00,000) |

## Question 30

What are the qualitative characteristics of the Financial Statements which improve the usefulness of the information furnished therein?

(*4 Marks*) (*November 2020*)

**Answer**

The qualitative characteristics are attributes that improve the usefulness of information provided in financial statements. Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise. The framework for Preparation and Presentation of Financial Statements suggests that the financial statements should maintain the following four qualitative characteristics to improve the usefulness of the information furnished therein.

1. **Understandability**: The financial statements should present information in a manner as to be readily understandable by the users with reasonable knowledge of business and economic activities and accounting.
2. **Relevance:** The financial statements should contain relevant information only. Information, which is likely to influence the economic decisions by the users, is said to be relevant. Such information may help the users to evaluate past, present or future events or may help in confirming or correcting past evaluations. The relevance of a piece of information should be judged by its materiality. A piece of information is said to be material if its misstatement (i.e., omission or erroneous statement) can influence economic decisions of a user.
3. **Reliability:** To be useful, the information must be reliable; that is to say, they must be free from material error and bias. The information provided are not likely to be reliable unless transactions and events reported are faithfully represented. The reporting of transactions and events should be neutral, i.e. free from bias and be reported on the principle of 'substance over form'. The information in financial statements must be complete. Prudence should be exercised in reporting uncertain outcome of transactions or events.
4. **Comparability:** Comparison of financial statements is one of the most frequently used and most effective tools of financial analysis. The financial statements should permit both inter-firm and intra-firm comparison. One essential requirement of comparability is disclosure of financial effect of change in accounting policies.

## Question 31

Following is the Balance Sheet of M/s. S Traders as on 31st March, 2019:

| **Liabilities** | **(₹)** | **Assets** | **(₹)** |
|---|---:|---|---:|
| Capital | 1,50,000 | Fixed Assets | 1,05,000 |
| 11% Bank Loan | 80,000 | Closing stock | 76,000 |
| Trade payables | 52,000 | Debtors | 68,000 |
| Profit & Loss A/c | 56,000 | Deferred Expenditure | 24,000 |
| | | Cash & Bank | 65,000 |
| | 3,38,000 | | 3,38,000 |

**Additional Information:**

(i) Remaining life of Fixed Assets is 6 years with even use. The net realizable value of Fixed Assets as on 31st March, 2020 is ₹ 90,000.

(ii) Firm's Sales & Purchases for the year ending 31st March, 2020 amounted to ₹7,80,000 and ₹6,25,000 respectively.

(iii) The cost & net realizable value of the stock as on 31st March, 2020 was, ₹ 60,000 and ₹ 66,000 respectively.

(iv) General expenses (including interest on Loan) for the year 2019-20 were ₹ 53,800.

(v) Deferred expenditure is normally amortised equally over 5 years starting from the Financial year 2018-19 i.e. ₹6,000 per year.

(vi) Debtors on 31st March, 2020 is ₹ 65,000 of which ₹ 5,000 is doubtful. Collection of another ₹ 10,000 debtors depends on successful re-installation of certain products supplied to the customer.

(vii) Closing Trade payable ₹ 48,000, which is likely to be settled at 5% discount.

(viii) There is a prepayment penalty of ₹ 4,000 for Bank loan outstanding.

(ix) Cash & Bank balances as on 31st March, 2020 is ₹ 1,65,200.

Prepare Profit & Loss Account for the year ended 31st March, 2020 and Balance Sheet as on 31st March, 2020 assuming the firm is not a going concern.

(*4 Marks*) (*November 2020*)

**Answer**

**Profit and Loss Account of M/s S Traders for the year ended 31st March, 2020 (business is not a going concern)**

| | ₹ | | ₹ |
|---|---|---|---|
| To Opening Stock | 76,000 | By Sales | 7,80,000 |
| To Purchases | 6,25,000 | By Trade payables | 2,400 |
| To General expenses | 53,800 | By Closing Stock | 66,000 |
| To Depreciation (1,05,000 less 90,000) | 15,000 | | |
| To Provision for doubtful debts | 15,000 | | |
| To Deferred expenditure | 24,000 | | |
| To Loan penalty | 4,000 | | |
| To Net Profit (b.f.) | 35,600 | | |
| | 8,48,400 | | 8,48,400 |

**Balance Sheet M/s S Traders as on 31st March, 2020**

| Liabilities and Capital | | ₹ | Assets | ₹ |
|---|---|---|---|---|
| Capital | | 1,50,000 | Fixed assets | 90,000 |
| Profit & Loss A/c | | | Debtors | |
| Opening balance | 56,000 | | (65,000 less provision for doubtful debts ₹ 15,000) | 50,000 |
| Profit earned during the year | 35,600 | 91,600 | Closing stock | 66,000 |
| 11% Loan | | 84,000 | Cash & Bank balance | 1,65,200 |
| Trade payables | | 45,600 | | |
| | | 3,71,200 | | 3,71,200 |

## Question 32

Mrs. A is showing the consolidated aggregate opening balance of equity, liabilities and assets of ₹ 6 lakh, 4 lakh and 10 lakh respectively. During the current year Mrs. A has the following transactions:

1. Received 20 % dividend on 10,000 equity shares of ₹ 10 each held as investment.
2. The amount of ₹ 70,000 is paid to creditors for settlement of₹90,000.
3. Salary is pending by ₹ 20,000.
4. Mrs. A's drawing ₹ 20,000 for her personal use.

You are required to prepare the statement of the effect of aforesaid each transactions on closing balance sheet in the form of Assets - Liabilities = Equity after each transaction.

(*Suggested December 2021*) (*4 Marks*)

**Answer**

**Effect of each transaction on Balance sheet of Mrs. A is shown below:**

| Transactions | Assets ₹ lakh | – | Liabilities ₹ lakh | = | Equity ₹ lakh |
|---|---|---|---|---|---|
| Opening | 10.00 | – | 4.00 | = | 6.00 |
| (1) Dividend earned | 10.20 [10.00+0.20] | – | 4.00 | = | 6.20 [6.00+0.20] |
| (2) Settlement of Creditors | 9.50 [10.20-0.70] | — | 3.10 [4.00-0.90] | = | 6.40 [6.20+0.20] |
| (3) Salary Outstanding | 9.50 | – | 3.30 [3.10+0.20] | = | 6.20 [6.40-0.20] |
| (4) Drawings | 9.30 [9.50-0.20] | – | 3.30 | = | 6.00 [6.20-0.20] |

## Similar Question

## Question 32A

Opening Balance Sheet of Mr. A is showing the aggregate value of assets, liabilities and equity ₹ 8 lakh, ₹ 3 lakh and ₹ 5 lakh respectively. During accounting period, Mr. A has the following transactions:

(1) Earned 10% dividend on 2,000 equity shares held of ₹ 100 each

(2) Paid ₹ 50,000 to creditors for settlement of ₹ 70,000

(3) Rent of the premises is outstanding ₹ 10,000

(4) Mr. A withdrew ₹ 9,000 for his personal use.

You are required to show the effect of above transactions on Balance Sheet in the form of Assets- Liabilities = Equity after each transaction.

*(MTP April, 2022) (5 Marks)*

**Answer**

**Effects of each transaction on Balance sheet of Mr. A is shown below:**

| Transactions | Assets ₹ lakh | – | Liabilities ₹ lakh | = | Equity ₹ lakh |
|---|---|---|---|---|---|
| Opening | 8.00 | – | 3.00 | = | 5.00 |
| (1) Dividend earned | 8.20 | – | 3.00 | = | 5.20 |
| (2) Settlement of Creditors | 7.70 | - | 2.30 | = | 5.40 |
| (3) Rent Outstanding | 7.70 | – | 2.40 | = | 5.30 |
| (4) Drawings | 7.61 | – | 2.40 | = | 5.21 |

## Question 33

What is meant by 'Measurement'? What are the bases of measurement of Elements of Financial Statements? Explain in brief. (*Suggested December 2021*) (*4 Marks*)

**Answer**

Measurement is the process of determining money value at which an element can be recognized in the balance sheet or statement of profit and loss. The Framework for Preparation and Presentation of Financial statements recognizes four alternative measurement bases for the purpose of determining the value at which an element can be recognized in the balance sheet or statement of profit and loss.

These bases are: (i) Historical Cost; (ii) Current cost (iii) Realizable (Settlement) Value and (iv) Present Value.

A brief explanation of each measurement basis is as follows:

1. **Historical Cost**: Historical cost means acquisition price. According to this, assets are recorded at an amount of cash or cash equivalent paid or the fair value of the asset at the time of acquisition. Liabilities are generally recorded at the amount of proceeds received in exchange for the obligation.
2. **Current Cost:** Current cost gives an alternative measurement basis. Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
3. **Realizable (Settlement) Value:** As per realizable value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in an orderly disposal. Liabilities are carried at their settlement values, i.e. the undiscounted amount of cash or cash equivalents paid to satisfy the liabilities in the normal course of business.
4. **Present Value**: Under present value convention, assets are carried at present value of future net cash flows generated by the concerned assets in the normal course of business. Liabilities under this convention are carried at present value of future net cash flows that are expected to be required to settle the liability in the normal course of business.

CHAPTER

# 3

# Overview of Accounting Standards

## AS 1: Disclosure of Accounting Policies

**Question 1**

*In the books of M/s Prashant Ltd., closing inventory as on 31.03.20X2 amounts to ₹ 1,63,000 (on the basis of FIFO method).*

*The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 20X1-X2. On the basis of weighted average method, closing inventory as on 31.03.20X2 amounts to ₹ 1,47,000. Realisable value of the inventory as on 31.03.20X2 amounts to ₹ 1,95,000.*

*Discuss disclosure requirement of change in accounting policy as per AS-1.*

(*Study Material*)

**Answer**

As per AS 1 "Disclosure of Accounting Policies", any change in an accounting policy which has a material effect should be disclosed in the financial statements. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Thus Prashant Ltd. should disclose the change in valuation method of inventory and its effect on financial statements. The company may disclose the change in accounting policy in the following manner:

'The company values its inventory at lower of cost and net realizable value. Since net realizable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 201X1-X2, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by ₹ 16,000.

**Question 2**

*Jagannath Ltd. had made a rights issue of shares in 20X2. In the offer document to its members, it had projected a surplus of ₹ 40 crores during the accounting year to end on 31st March, 20X2. The draft results for the year, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of ₹ 10 crores. The board in consultation with the managing director, decided on the following:*

*(i) Value year-end inventory at works cost (₹ 50 crores) instead of the hitherto method of valuation of inventory at prime cost (₹ 30 crores).*

*(ii) Provide depreciation for the year on straight line basis on account of substantial additions in gross block during the year, instead of on the reducing balance method, which was hitherto adopted. As a consequence, the charge for depreciation at ₹ 27 crores is lower than the amount of ₹ 45 crores which would have been provided had the old method been followed, by ₹ 18 cores.*

*(iii) Not to provide for "after sales expenses" during the warranty period. Till the last year, provision at 2% of sales used to be made under the concept of "matching of costs against revenue" and actual expenses used to be charged against the provision. The board now decided to account for expenses as and when actually incurred. Sales during the year total to ₹ 600 crores.*

*(iv) Provide for permanent fall in the value of investments - which fall had taken place over the past five years - the provision being ₹ 10 crores.*

*As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 20X1-20X2.*

(*Study Material*)

**Answer**

As per AS 1, any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Accordingly, the notes on accounts should properly disclose the change and its effect.

**Notes on Accounts:**

(i) During the year inventory has been valued at factory cost, against the practice of valuing it at prime cost as was the practice till last year. This has been done to take cognizance of the more capital intensive method of production on account of heavy capital expenditure during the year. As a result of this change, the year-end inventory has been valued at ₹ 50 crores and the profit for the year is increased by ₹ 20 crores.

(ii) In view of the heavy capital intensive method of production introduced during the year, the company has decided to change the method of providing depreciation from reducing balance method to straight line method. As a result of this change, depreciation has been provided at ₹ 27 crores which is lower than the charge which would have been made had the old method and the old rates been applied, by ₹ 18 crores. To that extent, the profit for the year is increased.

(iii) So far, the company has been providing 2% of sales for meeting "after sales expenses during the warranty period. With the improved method of production, the probability of defects occurring in the products has reduced considerably. Hence, the company has decided not to make provision for such expenses but to account for the same as and when expenses are incurred. Due to this change, the profit for the year is increased by ₹ 12 crores than would have been the case if the old policy were to continue.

(iv) The company has decided to provide ₹ 10 crores for the permanent fall in the value of investments which has taken place over the period of past five years. The provision so made has reduced the profit disclosed in the accounts by ₹ 10 crores.

## Question 3

*XYZ Company is engaged in the business of financial services and is undergoing tight liquidity position, since most of the assets of the company are blocked in various claims/petitions in a Special Court. XYZ has accepted Inter-Corporate Deposits (ICDs) and, it is making its best efforts to settle the dues. There were claims at varied rates of interest, from lenders, from the due date of ICDs to the date of repayment. The company has provided interest, as per the terms of the contract till the due date and a note for non-provision of interest on the due date to date of repayment was affected in the financial statements. On account of uncertainties existing regarding the determination of the amount and in the absence of any specific legal obligation at present as per the terms of contracts, the company considers that these claims are in the nature of "claims against the company not acknowledged as debt", and the same has been disclosed by way of a note in the accounts instead of making a provision in the profit and loss accounts. State whether the treatment done by the Company is correct or not.*

(*Study Material*)

**Answer**

AS 1 'Disclosure of Accounting Policies' recognises 'prudence' as one of the major considerations governing the selection and application of accounting policies. In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

Also as per AS 1, 'accrual' is one of the fundamental accounting assumptions. Irrespective of the terms of the contract, so long as the principal amount of a loan is not repaid, the lender cannot be replaced in a disadvantageous position for non- payment of interest in respect of overdue amount. From the aforesaid, it is apparent that the company has an obligation on account of the overdue interest. In this situation, the company should provide for the liability (since it is not waived by the lenders) at an amount estimated or on reasonable basis based on facts and circumstances of each case. However, in respect of the overdue interest amounts, which are settled, the liability should be accrued to the extent of amounts settled. Non-provision of the overdue interest liability amounts to violation of accrual basis of accounting. Therefore, the treatment, done by the company, of not providing the interest amount from due date to the date of repayment is not correct.

# QUESTION BANK

## Question 4

HIL Ltd. was making provision for non-moving stocks based on no issues having occurred for the last 12 months upto 31.03.2019. The company now wants to change it and make provision based on technical evaluation during the year ending 31.03.2020. Total value of stock on 31.3.20 is ₹ 120 lakhs. Provision required based on technical evaluation amounts ₹ 3.00 lakhs. However, provision required based on 12 months (no issues) is ₹ 4.00 lakhs. You are required to discuss the following points in the light of Accounting Standard (AS)-1:

(i) Does this amount to change in accounting policy?

(ii) Can the company change the method of accounting?

(iii) Explain how it will be disclosed in the annual accounts of HIL Ltd. for the year 2019 -20.

(*November 2018*)/*(MTP April, 2022) (5 Marks)*

**Answer**

The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be made but the basis for making provision will not constitute accounting policy. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory from ₹ 4 lakhs to ₹ 3 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of HIL Ltd. for the year 2019-20 in the following manner:

"The company has provided for non-moving inventories on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the value of net assets at the end of the year would have been lower by ₹ 1 lakh."

## Question 5

What are fundamental accounting assumptions?

(*RTP May 2019*)

**Answer:**

**Fundamental Accounting Assumptions:**

Accrual, Going Concern and Consistency

## Question 6

Kumar Ltd. had made a rights issue of shares in 2017. In the offer document to its members, it had projected a surplus of ₹ 40 crores during the accounting year to end on 31st March, 2017. The draft results for the year, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of ₹ 10 crores. The board in consultation with the managing director, decided not to provide for "after sales expenses" during the warranty period. Till the last year, provision at 2% of sales used to be made under the concept of "matching of costs against revenue" and actual expenses used to be charged against the provision. The board now decided to account for expenses as and when actually incurred. Sales during the year total to ₹ 600 crores.

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2016-2017.

(*MTP April 2019*) (*5 Marks*)

**Answer:**

As per AS 1, any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Accordingly, the notes on accounts should properly disclose the change and its effect.

**Notes on Accounts:**

So far, the company has been providing 2% of sales for meeting "after sales expenses during the warranty period. With the improved method of production, the probability of defects occurring in the products has reduced considerably. Hence, the company has decided not to make provision for such expenses but to account for the same as and when expenses are incurred. Due to this change, the profit for the year is increased by ₹ 12 crores than would have been the case if the old policy were to continue.

## Question 7

Kumar Ltd. had made a rights issue of shares in 2017. In the offer document to its members, it had projected a surplus of ₹ 40 crores during the accounting year to end on 31st March, 2017. The draft results for the year, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of ₹ 10 crores. The board in consultation with the managing director, decided not to provide for “after sales expenses” during the warranty period. Till the last year, provision at 2% of sales used to be made under the concept of “matching of costs against revenue” and actual expenses used to be charged against the provision. The board now decided to account for expenses as and when actually incurred. Sales during the year total to ₹ 600 crores.

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2016 -2017.

(*MTP August, 2018*) (*5 Marks*)

**Answer:**

As per AS 1, any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Accordingly, the notes on accounts should properly disclose the change and its effect.

**Notes on Accounts:**

So far, the company has been providing 2% of sales for meeting “after sales expenses during the warranty period. With the improved method of production, the probability of defects occurring in the products has reduced considerably. Hence, the company has decided not to make provision for such expenses but to account for the same as and when expenses are incurred. Due to this change, the profit for the year is increased by ₹ 12 crores than would have been the case if the old policy were to continue.

## Question 8

In the books of M/s Prashant Ltd., closing inventory as on 31.03.2015 amounts to ₹ 1,63,000 (on the basis of FIFO method).

The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 2014-15. On the basis of weighted average method, closing inventory as on 31.03.2015 amounts to ₹ 1,47,000. Realisable value of the inventory as on 31.03.2015 amounts to ₹ 1,95,000.

Discuss disclosure requirement of change in accounting policy as per AS-1.

(*MTP October, 2018*) (*5 Marks*)

**Answer:**

As per AS 1 “Disclosure of Accounting Policies”, any change in an accounting policy which has a material effect should be disclosed in the financial statements. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Thus Prashant Ltd. should disclose the change in valuation method of inventory and its effect on financial statements. The company may disclose the change in accounting policy in the following manner:

‘The company values its inventory at lower of cost and net realisable value. Since net realisable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 2014 -15, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by ₹ 16,000.

## Question 9

Kumar Ltd. had made a rights issue of shares in 2017. In the offer document to its members, it had projected a surplus of ₹ 40 crores during the accounting year to end on 31st March, 2017. The draft results for the year, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of ₹ 10 crores. The board in consultation with the managing director, decided not to provide for "after sales expenses" during the warranty period. Till the last year, provision at 2% of sales used to be made under the concept of "matching of costs against revenue" and actual expenses used to be charged against the provision. The board now decided to account for expenses as and when actually incurred. Sales during the year total to ₹ 600 crores.

As chief accountant of the company, you are asked by the managing director to prepare the notes on accounts for inclusion in the annual report for 2016-2017.

(*MTP April, 2018*) (*5 Marks*)

**Answer**

As per AS 1, any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Accordingly, the notes on accounts should properly disclose the change and its effect.

**Notes on Accounts:**

So far, the company has been providing 2% of sales for meeting "after sales expenses during the warranty period. With the improved method of production, the probability of defects occurring in the products has reduced considerably. Hence, the company has decided not to make provision for such expenses but to account for the same as and when expenses are incurred. Due to this change, the profit for the year is increased by ₹12 crores than would have been the case if the old policy were to continue.

## Question 10

What are the three fundamental accounting assumptions recognized by Accounting Standard (AS) 1? Briefly describe each one of them.

[*RTP, November 2020*]

**Answer**

Accounting Standard (AS) 1 recognizes three fundamental accounting assumptions. These are as follows:

(i) Going Concern: The financial statements are normally prepared on the assumption that an enterprise will continue its operations in the foreseeable future and neither there is intention, nor there is need to materially curtail the scale of operations.

(ii) Consistency: The principle of consistency refers to the practice of using same accounting policies for similar transactions in all accounting periods unless the change is required (i) by a statute, (ii) by an accounting standard or (iii) for more appropriate presentation of financial statements.

(iii) Accrual basis of accounting: Under this basis of accounting, transactions are recognised as soon as they occur, whether or not cash or cash equivalent is actually received or paid.

## Question 11

The draft results of Surya Ltd. for the year ended 31st March, 2020, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of ₹ 10 crores. The board in consultation with the managing director, decided to value year-end inventory at works cost (₹ 50 crores) instead of the hitherto method of valuation of inventory at prime cost (₹ 30 crores). As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2019-2020.

**Answer**

As per AS 1, any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Accordingly, the notes on accounts should properly disclose the change and its effect.

**Notes on Accounts:**

“During the year inventory has been valued at factory cost, against the practice of valuing it at prime cost as was the practice till last year. This has been done to take cognizance of the more capital intensive method of production on account of heavy capital expenditure during the year. As a result of this change, the year-end inventory has been valued at ₹ 50 crores and the profit for the year is increased by ₹ 20 crores.”

## Question 12

(a) ABC Ltd. was making provision for non-moving inventories based on no issues for the last 12 months up to 31.3.2019.

The company wants to provide during the year ending 31.3.2020 based on technical evaluation:

| | |
|---|---|
| Total value of inventory | ₹ 100 lakhs |
| Provision required based on 12 months issue | ₹ 3.5 lakhs |
| Provision required based on technical evaluation | ₹ 2.5 lakhs |

Does this amount to change in Accounting Policy? Can the company change the method of provision?

(*RTP May 2020*)

(b) State whether the following statements are 'True' or 'False'. Also give reason for your answer.

1. Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.
2 If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.
3. All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.
4. Any change in an accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need not to be indicated.

(*RTP May 2020*) (*MTP March, 2022*) (*5 Marks*)/(*Question Paper, May 2022*) (*4 Marks*)

**Answer**

**(a) (i)** The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made. In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory from ₹ 3.5 lakhs to ₹ 2.5 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2019-20:

"The company has provided for non-moving inventories on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been lower by ₹ 1 lakh."

(b) 1. False; As per AS 1 "Disclosure of Accounting Policies", certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

2. False; As per AS 1, if the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

3. True; To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed in one place.

4. False; Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

## Question 13

HIL Ltd. was making provision for non-moving stocks based on no issues having occurred for the last 12 months upto 31.03.2019. The company now wants to change it and make provision based on technical evaluation during the year ending 31.03.2020. Total value of stock on 31.3.20 is ₹ 120 lakhs. Provision required based on technical evaluation amounts ₹ 3.00 lakhs. However, provision required based on 12 months (no issues) is ₹ 4.00 lakhs. You are required to discuss the following points in the light of Accounting Standard (AS)-1:

(i) Does this amount to change in accounting policy?

(ii) Can the company change the method of accounting?

(iii) Explain how it will be disclosed in the annual accounts of HIL Ltd. for the year 2019-20.

(*5 Marks*)

**Answer**

The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be made but the basis for making provision will not constitute accounting policy. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory from ₹ 4 lakhs to ₹ 3 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of HIL Ltd. for the year 2019-20 in the following manner:

"The company has provided for non-moving inventories on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the value of net assets at the end of the year would have been lower by ₹ 1 lakh."

## Question 14

What are the three fundamental accounting assumptions recognised by Accounting Standard (AS) 1? Briefly describe each one of them.

(*Study Material*)

**Answer**

Accounting Standard (AS) 1 recognises three fundamental accounting assumptions. These are: (i) Going Concern; (ii) Consistency; (iii) Accrual basis of accounting.

## Question 15

When can a company change its accounting policy? Explain.

(*Study Material*)

**Answer**

A change in accounting policy should be made in the following conditions:

(i) If the change is required by some statute or

(ii) for compliance with an Accounting Standard or

(iii) change would result in more appropriate presentation of the financial statement.

## Question 16

State whether the following statements are 'True' or 'False'. Also give reason for your answer.

(i) Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.

(ii) If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.

(iii) All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.

(iv) Any change in an accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need not to be indicated.

(*Study Material*)

**Answer**

(i) False; As per AS 1 "Disclosure of Accounting Policies", certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

(ii) False; As per AS 1, if the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

(iii) True; To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed in one place.

(iv) False; Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

## Question 17

State whether the following statements are 'True' or 'False' in line with the provisions of AS 1. Also give reason for your answer.

(i) Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.

(ii) If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.

(iii) All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.

(iv) Any change in an accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need not to be indicated.

(v) There is no single list of accounting policies which are applicable to all circumstances.

(*5 Marks*)

**Answer**

(i) False; As per AS 1 "Disclosure of Accounting Policies", certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

(ii) False; As per AS 1, if the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

(iii) True; To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed at one place.

(iv) False; Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

(v) True; As per AS 1, there is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable.

## Question 18

State whether the following statements are 'True' or 'False'. Also give reason for your answer.

(i) Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.

(ii) If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.

(iii) All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.

(iv) Any change in an accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need not to be indicated.

(v) There is no single list of accounting policies which are applicable to all circumstances.

[*MTP October, 2019, 5 marks*]

**Answer**

**(i) False**: As per AS 1 "Disclosure of Accounting Policies", certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

**(ii) False**: As per AS 1, if the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

**(iii) True**: To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed at one place.

**(iv) False**: Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

**(v) True**: As per AS 1, there is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable.

## Question 19

State whether the following statements are 'True' or 'False'. Also give reason for your answer.

(i) Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed.

(ii) If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.

(iii) All significant accounting policies adopted in the preparation and presentation of financial statements should not form part of the financial statements.

(iv) Any change in an accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need to be indicated.

(v) There is a single list of accounting policies which are applicable to all circumstances.

*(5 Marks) (MTP, May 2020)*

**Answer:**

**(i) True;** As per AS 1 “Disclosure of Accounting Policies”, certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

**(ii) False;** As per AS 1, if the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

**(iii) False;** To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed in one place.

**(iv) True;** Any change in the accounting policies which has a material effect in the current period, or which is reasonably expected to have a material effect in later periods should be disclosed. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

**(v) False**; As per AS 1, there is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable.

## Question 20

In the books of Rani Ltd., closing inventory as on 31.03.2020 amounts to ₹ 1,75,000 (valued on the basis of FIFO method). The Company decides to change from FIFO method to weighted average method for ascertaining the costs of inventory from the year 2019-20. On the basis of weighted average method, closing inventory as on 31.03.2020 amounts to ₹1,59,000. Realizable value of the inventory as on 31.03.2020 amounts to ₹ 2,07,000. Discuss disclosure requirements of change in accounting policy as per AS 1.

(*MTP, November, 2021*) (*5 Marks*)

**Answer**

As per AS 1 “Disclosure of Accounting Policies”, any change in an accounting policy which has a material effect should be disclosed in the financial statements. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Thus Rani Ltd. should disclose the change in valuation method of inventory and its effect on financial statements. The company may disclose the change in accounting policy in the following manner:

"The company values its inventory at lower of cost and net realizable value. Since net realizable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 2019-20, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by ₹ 16,000 (1,75,000 – 1,59,000)."

## Question 21

(i) ABC Ltd. was previously making provision for non-moving stocks based on not issued for the last 12 months up to 31.03.2020. Now, the company wants to make provision based on technical evaluation during the year ending 31.03.2021.

Total value of stock ₹ 133.75 lakhs

Provision required based on technical evaluation ₹4.00 lakhs Provision required based on 12 months not issued ₹5.00 lakhs

(ii) In the Books of M/s Kay Ltd, Closing stock as on 31st March, 2021 amounts to ₹1,24,000 (on the basis of FIFO method)

The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 2020-2021. On the basis of weighted average method, closing stock as on 31st March, 2021 amounts to 1 1,15,000. Realisable value of the inventory as on 31st March, 2021 amounts to ₹ 1,54,000.

Discuss Disclosure Requirements of change in accounting policy in above cases as per AS 1

(*Suggested December 2021*) (*5 Marks*)

**Answer**

(i) The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory from ₹ 5 lakhs to ₹ 4 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2020 -21:

"The company has provided for non-moving inventories on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been lower by ₹ 1 lakh."

(ii) As per AS 1 "Disclosure of Accounting Policies", any change in an accounting policy which has a material effect should be disclosed in the financial statements. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Thus company should disclose the change in valuation method of inventory and its effect on financial statements. The company may disclose the change in accounting policy in the following manner:

"The company values its inventory at lower of cost and net realizable value. Since net realizable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 2020-21, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by ₹ 9,000."

# AS 2 (Revised): Valuation of Inventory

## Question 22

*A trader purchased certain articles for ₹ 85,000. He sold some of articles for ₹ 1,05,000. The average percentage of gross margin is 25% on cost. Opening stock of inventory at cost was ₹ 15,000. Calculate stock*

**Answer**

*Cost of closing inventory is shown below:*

| | ₹ |
|---|---|
| *Sale value of opening stock and purchase (₹85,000 + ₹15,000) x 1.25* | *1,25,000* |
| *Sales* | *(1,05,000)* |
| *Sale value of unsold stock* | *20,000* |
| *Less: Gross Margin (₹20,000 / 1.25) x 0.25* | *(4,000)* |
| *Cost of inventory* | *16,000* |

## Question 23

*The company deals in three products, A, B and C, which are neither similar nor interchangeable. At the time of closing of its account for the year 20X1-X2, the Historical Cost and Net Realisable Value of the items of closing stock are determined as follows:*

| ***Items*** | ***Historical Cost (₹ in lakhs)*** | ***Net Realisable Value (₹ in lakhs)*** |
|---|---|---|
| *A* | *40* | *28* |
| *B* | *32* | *32* |
| *C* | *16* | *24* |

*What will be the value of closing stock?*

(*Study Material*)

**Answer**

As per AS 2 (Revised) on 'Valuation of Inventories', inventories should be valued at the lower of cost and net realisable value. Inventories should be written down to net realisable value on an item-by-item basis in the given case.

| ***Items*** | ***Historical Cost (₹ in lakhs)*** | ***Net Realisable Value (₹ in lakhs)*** | ***Valuation of closing stock (₹ in lakhs)*** |
|---|---|---|---|
| A | 40 | 28 | 28 |
| B | 32 | 32 | 32 |
| C | 16 | 24 | 16 |
| | 88 | 84 | 76 |

Hence, closing stock will be valued at ₹ 76 lakhs.

## Question 24

*X Co. Limited purchased goods at the cost of ₹ 40 lakhs in October, 20X1. Till March, 20X2, 75% of the stocks were sold. The company wants to disclose closing stock at ₹ 10 lakhs. The expected sale value is ₹ 11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct closing stock to be disclosed as at 31.3.20X2.*

(*Study Material*)

**Answer**

As per AS 2 (Revised) "Valuation of Inventories", the inventories are to be valued at lower of cost or net realisable value.

In this case, the cost of inventory is ₹ 10 lakhs. The net realisable value is 11,00,000×90% = ₹ 9,90,000. So, the stock should be valued at ₹ 9,90,000.

## Question 25

*In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input is ₹ 1,000. The entire quantity of waste is on stock at the year end. State with reference to Accounting Standard, how will you value the inventories in this case?*

(*Study Material*)

**Answer**

As per AS 2 (Revised), abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred.

In this case, normal waste is 250 MT and abnormal waste is 50 MT. The cost of 250 MT will be included in determining the cost of inventories (finished goods) at the year end. The cost of abnormal waste (50 MT x 1,052.6315 = ₹ 52,632) will be charged to the profit and loss statement.

Cost per MT (Normal Quantity of 4,750 MT) = 50,00,000 / 4,750 = ₹ 1,052.6315 Total value of inventory = 4,700 MT x ₹ 1,052.6315 = ₹ 49,47,368.

## Question 26

*You are required to value the inventory per kg of finished goods consisting of:*

| | ***₹ per kg.*** |
|---|---:|
| *Material cost* | *200* |
| *Direct labour* | *40* |
| *Direct variable overhead* | *20* |

*Fixed production charges for the year on normal working capacity of 2 lakh kgs is ₹ 20 lakhs. 4,000 kgs of finished goods are in stock at the year end.*

(*Study Material*)

**Answer**

In accordance with AS 2 (Revised), the cost of conversion include a systematic allocation of fixed and variable overheads that are incurred in converting materials into finished goods. The allocation of fixed overheads for the purpose of their inclusion in the cost of conversion is based on normal capacity of the production facilities.

Cost per kg. of finished goods:

| | | ₹ |
|---|---:|---:|
| Material Cost | | 200 |
| Direct Labour | 40 | |
| Direct Variable Production Overhead | 20 | |
| Fixed Production Overhead $\left(\frac{20,00,000}{2,00,000}\right)$ | <u>10</u> | <u>70</u> |
| | | <u>270</u> |

Hence the value of 4,000 kgs. of finished goods = 4,000 kgs x ₹ 270 = ₹ 10,80,000

## Question 27

*On 31st March 20X1, a business firm finds that cost of a partly finished unit on that date is ₹ 530. The unit can be finished in 20X1-X2 by an additional expenditure of ₹ 310. The finished unit can be sold for ₹ 750 subject to payment of 4% brokerage on selling price. The firm seeks your advice regarding the amount at which the unfinished unit should be valued as at 31st March, 20X1 for preparation of final accounts. Assume that the* partly finished unit cannot be sold in *semi-finished form and its NRV is zero without processing it further.*

(*Study Material*)

**Answer**

**Valuation of unfinished unit**

| | ₹ |
|---|---:|
| Net selling price | 750 |
| *Less*: Estimated cost of completion | (310) |
| | 440 |
| *Less*: Brokerage (4% of 750) | (30) |
| Net Realisable Value | 410 |
| Cost of inventory | 530 |
| Value of inventory (Lower of cost and net realisable value) | 410 |

# QUESTION BANK

## Question 28

State whether the following statements are 'True' or 'False'. Also give reason for your answer.

As per the provisions of AS-2, inventories should be valued at the lower of cost and selling price.

(*May 2019*) (*1 Marks*)

**Answer**

**False:** Inventories should be valued at the lower of cost and net realizable value (not selling price) as per AS 2.

## Question 29

Wooden Plywood Limited has a normal wastage of 5% in the production process. During the year 2017-18, the Company used 16,000 MT of Raw material costing ₹ 190 per MT. At the end of the year, 950 MT of wastage was in stock. The accounting wants to know haw this wastage is to be treated in the books.

You are required to:

(1) Calculate the amount of abnormal loss.

(2) Explain the treatment of normal loss and abnormal loss.
[In the context of AS-2- (Revised)]

(*May 2019*) (*5 Marks*)

**Answer**

(i) As per AS 2 (Revised) 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

**Amount of Abnormal Loss:**

| | | |
|---|---|---|
| (ii) | Material used | 16,000 MT @ ₹ 190 = ₹ 30,40,000 |
| | Normal Loss (5% of 16,000 MT) | 800 MT (included in calculation of cost of inventories) |
| | Net quantity of material | 15,200 MT |
| (ii) | Abnormal Loss in quantity | (950 - 800) 150 MT |
| | Abnormal Loss | ₹ 30,000 |

[150 units @ ₹ 200 (₹ 30,40,000/15,200)]

Amount of ₹ 30,000 (Abnormal loss) will be charged to the Profit and Loss statement.

## Question 30

On 31st March 2017, a business firm finds that cost of a partly finished unit on that date is ₹ 530. The unit can be finished in 2017-18 by an additional expenditure of ₹ 310. The finished unit can be sold for ₹ 750 subject to payment of 4% brokerage
on selling price. The firm seeks your advice regarding the amount at which the unfinished unit should be valued as at 31st March, 2017 for preparation of final accounts. Assume that the partly finished unit cannot be sold in semi finished form and its NRV is zero without processing it further.

(*RTP May 2019*)

**Answer:**

**Valuation of unfinished unit**

| | ₹ |
|---|---:|
| Net selling price | 750 |
| *Less*: Estimated cost of completion | (310) |
| | 440 |
| *Less*: Brokerage (4% of 750) | (30) |
| Net Realisable Value | 410 |
| Cost of inventory | 530 |
| Value of inventory (Lower of cost and net realisable value) | 410 |

## Question 31

A Limited is engaged in manufacturing of Chemical Y for which Raw Material X is required. The company provides you following information for the year ended 31st March, 2017.

| | **₹ Per unit** |
|---|---:|
| **Raw Material X** | |
| Cost price | 380 |
| Unloading Charges | 20 |
| Freight Inward | 40 |
| Replacement cost | 300 |
| **Chemical Y** | |
| Material consumed | 440 |
| Direct Labour | 120 |
| Variable Overheads | 80 |

**Additional Information:**

(i) Total fixed overhead for the year was ₹ 4,00,000 on normal capacity of 20,000 units.

(ii) Closing balance of Raw Material X was 1,000 units and Chemical Y was ₹ 2,400 units.

You are required to calculate the total value of closing stock of Raw Material X and Chemical Y according to AS 2, when

(i) Net realizable value of Chemical Y is ₹ 800 per unit

(ii) Net realizable value of Chemical Y is ₹ 600 per unit

(*RTP November 2018*)

**Answer:**

**(i) When Net Realizable Value of the Chemical Y is ₹ 800 per unit**

NRV is greater than the cost of Finished Goods Y i.e. ₹ 660 (Refer W.N.)

Hence, Raw Material and Finished Goods are to be valued at cost.

**Value of Closing Stock**

| | Qty. | Rate (₹) | Amount (₹) |
|---|---|---|---|
| Raw Material X | 1,000 | 440 | 4,40,000 |
| Finished Goods Y | 2.400 | 660 | 15,84,000 |
| Total Value of Closing Stock | | | 20,24,000 |

**(ii) When Net Realizable Value of the Chemical Y is ₹ 600 per unit**

NRV is less than the cost of Finished Goods Y i.e. ₹ 660. Hence, Raw Material is to be valued at replacement cost and Finished Goods are to be valued at NRV since NRV is less than the cost.

**Value of Closing Stock**

| | Qty. | Rate (₹) | Amount (₹) |
|---|---|---|---|
| Raw Material X | 1,000 | 300 | 3,00,000 |
| Finished Goods Y | 2,400 | 600 | 14,40,000 |
| Total Value of Closing Stock | | | 17,40,000 |

**Working Note:**

**Statement showing cost calculation of Raw material X and Chemical Y**

| **Raw Material X** | **₹** |
|---|---|
| Cost Price | 380 |
| Add: Freight Inward | 40 |
| Unloading charges | 20 |
| Cost | 440 |
| **Chemical Y** | **₹** |
| Materials consumed | 440 |
| Direct Labour | 120 |
| Variable overheads | 80 |
| Fixed overheads (₹4,00,000/20,000 units) | 20 |
| Cost | 660 |

## Question 32

A private limited company manufacturing fancy terry towels had valued its closing inventory of inventories of finished goods at the realizable value, inclusive of profit and the export cash incentives. Firm contracts had been received and goods were packed for export but the ownership in these goods had not been transferred to the foreign buyers.

You are required to advise the company on the valuation of the inventories in line with the provisions of AS 2.

(*RTP May 2018*)

**Answer:**

Accounting Standard 2 "Valuation of Inventories" states that inventories should be valued at lower of historical cost and net realizable value. The standard states, "at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases, when sale is assured under forward contract or a government guarantee or when market exists and there is a negligible risk of failure to sell, the goods are often valued at net realizable value at certain stages of production".

Terry Towels do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing inventory of finished goods (Fancy terry towel) should have been valued at lower of cost and net realizable value and not at net realizable value. Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing inventory of inventories of finished goods is not correct.

# Similar Question

## Question 32A

Rohan Pvt. Ltd., a wholesaler in agriculture products, has valued the inventory on Net Realizable Value on the ground that AS 2 does not apply to inventory of agriculture products.

*(RTP May, 2022)*

**Answer**

AS 2 does not apply to producers of agricultural products but applies to traders in agricultural products. Hence AS 2 will apply to Rohan Pvt. Ltd. and it will have to value inventory at lower of cost or market value.

## Question 33

On the basis of information given below, find the value of inventory (by periodic inventory method) as per AS 2, to be considered while preparing the Balance Sheet as on 31st March, 2017 on weighted Average Basis.

**Details of Purchases:**

| Date of purchase | Unit (Nos.) | Purchase cost per unit (₹) |
|---|---|---|
| 01-03-2017 | 20 | 108 |
| 08-03-2017 | 15 | 107 |
| 17-03-2017 | 30 | 109 |
| 25-03-2017 | 15 | 107 |

**Details of issue of Inventory:**

| Date of Issue | Unit (Nos.) |
|---|---|
| 03-03-2017 | 10 |
| 12-03-2017 | 20 |
| 18-03-2017 | 10 |
| 24-03-2017 | 20 |

Net realizable value of inventory as on 31st March, 2017 is ₹ 107.75 per unit.

You are required to compute the value of Inventory as per AS 2.

(*MTP March 2019*) (*5 Marks*)/(*RTP May 2022*)

**Answer:**

Net Realisable Value of Inventory as on 31$^{st}$ March, 2017

= ₹ 107.75 x 20 units = ₹ 2,155

**Value of inventory as per Weighted Average basis**

Total units purchased and total cost:

| | |
|---|---|
| 01.03.2017 | ₹ 108 x 20 units = ₹ 2160 |
| 08.3.2017 | ₹ 107 x 15 units = ₹ 1605 |
| 17.03.2017 | ₹ 109 x 30 units = ₹ 3270 |
| 25.03.2017 | ₹ 107 x 15 units = ₹ 1605 |
| Total | 80 units = ₹ 8640 |

Weighted Average Cost = ₹ 8640/80 units = ₹108

Total cost = ₹ 108 x 20 units = ₹ 2,160

Value of inventory to be considered while preparing Balance Sheet as on 31st March, 2017 is, Cost or Net Realisable value whichever is lower i.e. ₹ 2,155.

## Question 34

Omega Ltd., has a normal wastage of 4% in the production process. During the year 2016-17, the Company used 12,000 MT of raw material costing ₹ 150 per MT. At the end of the year 630 MT of wastage was ascertained in stock. The accountant wants to know how this wastage is to be treated in the books.

You are required to compute the amount of normal and abnormal loss and treatment thereof in line with AS 2 "Valuation of inventories". (*MTP April 2019*) (*5 Marks*)

**Answer:**

As per para AS 2 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

**Amount of Normal Loss and Abnormal Loss:**

| | |
|---|---|
| Material used | 12,000 MT @ ₹ 150 = ₹ 18,00,000 |
| Normal Loss (4% of 12,000 MT) | 480 MT |
| Net quantity of material | 11,520 MT |
| Abnormal Loss in quantity | 150 MT (630 MT less 480 MT) |
| Abnormal Loss | ₹ 23,437.50 [150 units @ ₹ 156.25 (₹18,00,000/11,520)] |

Amount ₹ 23,437.50 will be charged to the Profit and Loss statement.

## Question 35

A Limited is engaged in manufacturing of Chemical Y for which Raw Material X is required. The company provides you following information for the year ended 31$^{st}$ March, 2017.

| | ₹ Per unit |
|---|---|
| **Raw Material X** | |
| Cost price | 380 |
| Unloading Charges | 20 |
| Freight Inward | 40 |
| Replacement cost | 300 |

| **Chemical Y** | |
|---|---|
| Material consumed | 440 |
| Direct Labour | 120 |
| Variable Overheads | 80 |

Additional Information:

(i) Total fixed overhead for the year was ₹ 4,00,000 on normal capacity of 20,000 units.

(ii) Closing balance of Raw Material X was 1,000 units and Chemical Y was ₹ 2,400 units.

You are required to calculate the total value of closing stock of Raw Material X and Chemical Y according to AS 2, when Net realizable value of Chemical Y is ₹ 800 per unit.

(*MTP August, 2018*) (*5 Marks*)

**Answer:**

When Net Realizable Value of the Chemical Y is ₹ 800 per unit

NRV is greater than the cost of Finished Goods Y i.e. ₹ 660 (Refer W.N.)

Hence, Raw Material and Finished Goods are to be valued at cost.

**Value of Closing Stock:**

| | ***Qty.*** | ***Rate (₹)*** | ***Amount (₹)*** |
|---|---|---|---|
| Raw Material X | 1,000 | 440 | 4,40,000 |
| Finished Goods Y | 2,400 | 660 | 15,84,000 |
| Total Value of Closing Stock | | | 20,24,000 |

**Working Note:**

**Statement showing cost calculation of Raw material X and Chemical Y**

| **Raw Material X** | ***₹*** |
|---|---|
| Cost Price | 380 |
| *Add*: Freight Inward | 40 |
| Unloading charges | 20 |
| Cost | 440 |

| **Chemical Y** | ***₹*** |
|---|---|
| Materials consumed | 440 |
| Direct Labour | 120 |
| Variable overheads | 80 |
| Fixed overheads (₹4,00,000/20,000 units) | 20 |
| Cost | 660 |

## Question 36

Omega Ltd., has a normal wastage of 4% in the production process. During the year 2016 -17, the Company used 12,000 MT of raw material costing ₹ 150 per MT. At the end of the year 630 MT of wastage was ascertained in stock. The accountant wants to know how this wastage is to be treated in the books.

You are required to compute the amount of normal and abnormal loss and treatment thereof in line with AS 2 "Valuation of inventories".

(*MTP October, 2018*) (*5 Marks*)

**Answer:**

As per para AS 2 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred . The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

**Amount of Normal Loss and Abnormal Loss:**

| | |
|---|---|
| Material used | 12,000 MT @ ₹ 150 = ₹ 18,00,000 |
| Normal Loss (4% of 12,000 MT) | 480 MT |
| Net quantity of material | 11,520 MT |
| Abnormal Loss in quantity | 150 MT (630 MT less 480 MT) |
| Abnormal Loss | ₹ 23,437.50 [150 units @ ₹ 156.25 (₹18,00,000/11,520)] |

Amount of ₹ 23,437.50 will be charged to the Profit and Loss statement.

## Question 37

On the basis of information given below, find the value of inventory (by periodic inventory method) as per AS 2, to be considered while preparing the Balance Sheet as on 31st March, 2017 on weighted Average Basis.

**Details of Purchases:**

| **Date of purchase** | **Unit (Nos.)** | **Purchase cost per unit (₹)** |
|---|---|---|
| 01-03-2017 | 20 | 108 |
| 08-03-2017 | 15 | 107 |
| 17-03-2017 | 30 | 109 |
| 25-03-2017 | 15 | 107 |

**Details of issue of Inventory:**

| **Date of Issue** | **Unit (Nos.)** |
|---|---|
| 03-03-2017 | 10 |
| 12-03-2017 | 20 |
| 18-03-2017 | 10 |
| 24-03-2017 | 20 |

Net realizable value of inventory as on 31st March, 2017 is ₹ 107.75 per unit.

You are required to compute the value of Inventory as per AS 2?

(*MTP March 2018*) (*5 Marks*)

**Answer**:

Net Realisable Value of Inventory as on 31st March, 2017

= ₹ 107.75 x 20 units = ₹ 2,155

**Value of inventory as per Weighted Average basis**

*Total units purchased and total cost:*

| | |
|---|---|
| 01.03.2017 | ₹ 108 x 20 units = ₹ 2160 |
| 08.3.2017 | ₹ 107 x 15 units = ₹ 1605 |
| 17.03.2017 | ₹ 109 x 30 units = ₹ 3270 |
| 25.03.2017 | ₹ 107 x 15 units = ₹ 1605 |

Total 80 units = ₹ 8640

Weighted Average Cost = ₹ 8640/80 units = ₹108

Total cost = ₹ 108 x 20 units = ₹ 2,160

Value of inventory to be considered while preparing Balance Sheet as on 31st March, 2017 is, Cost or Net Realisable value whichever is lower i.e. ₹ 2,155.

## Question 38

Omega Ltd., has a normal wastage of 4% in the production process. During the year 2016-17, the Company used 12,000 MT of raw material costing ₹ 150 per MT. At the end of the year 630 MT of wastage was ascertained in stock. The accountant wants to know how this wastage is to be treated in the books.

You are required to compute the amount of normal and abnormal loss and give the treatment thereof in line with AS 2 "Valuation of inventories".

(*MTP April, 2018*) (*5 Marks*)

**Answer:**

As per para AS 2 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

Amount of Normal Loss and Abnormal Loss:

| | | |
|---|---|---|
| Material used | 12,000 MT @ ₹ 150 = ₹ 18,00,000 | |
| Normal Loss (4% of 12,000 MT) | 480 MT | |
| Net quantity of material | 11,520 MT | |
| Abnormal Loss in quantity | 150 MT (630 MT less 480 MT) | |
| Abnormal Loss | ₹ 23,437.50 [150 units @ ₹ 156.25 | (₹16,00,000/11,520)] |

Amount ₹ 23,437.50 will be charged to the Profit and Loss statement.

## Question 39

Hello Ltd. purchased goods at the cost of ₹ 20 lakhs in October. Till the end of the financial year, 75% of the stocks were sold. The Company wants to disclose closing stock at ₹ 5 lakhs. The expected sale value is ₹ 5.5 lakhs and a commission at 10% on sale is payable to the agent. You are required to ascertain the value of closing stock?

(*RTP November 2019*)

**Answer**

As per para 5 of AS 2 “Valuation of Inventories”, the inventories are to be valued at lower of cost or net realizable value.

In this case, the cost of inventory is ₹5 lakhs. The net realizable value is ₹4.95 lakhs (₹5.5 lakhs less cost to make the sale @ 10% of ₹5.5 lakhs). So, the closing stock should be valued at ₹4.95 lakhs.

## Question 40

A Limited is engaged in manufacturing of Chemical Y for which Raw Material X is required. The company provides you following information for the year ended 31st March, 2020.

| | ₹ Per unit |
|---|---|
| **Raw Material X** | |
| Cost price | 400 |
| Freight Inward | 40 |
| Replacement cost | 320 |
| **Chemical Y** | |
| Material consumed | 440 |
| Direct Labour | 120 |
| Variable Overheads | 80 |

**Additional Information:**

(i) Total fixed overhead for the year was ₹ 4,00,000 on normal capacity of 25,000 units.

(ii) Closing balance of Raw Material X was 1,000 units and Chemical Y was 2,400 units.

You are required to calculate the total value of closing stock of Raw Material X and Chemical Y according to AS 2, when Net realizable value of Chemical Y is ₹ 600 per unit.

[*RTP, November 2020*]

**Answer**

Net Realizable Value of the Chemical Y (Finished Goods) is ₹ 600 per unit which is less than its cost ₹ 656 per unit. Hence, Raw Material is to be valued at replacement cost and Finished Goods are to be valued at NRV since NRV is less than the cost.

**Value of Closing Stock:**

| | Qty. | Rate (₹) | Amount (₹) |
|---|---|---|---|
| Raw Material X | 1,000 | 320 | 3,20,000 |
| Finished Goods Y | 2,400 | 600 | 14,40,000 |
| Total Value of Closing Stock | | | 17,60,000 |

**Working Note:**

**Statement showing cost calculation of Raw material X and Chemical Y**

| **Raw Material X** | **₹** |
|---|---|
| Cost Price | 400 |
| Add: Freight Inward | 40 |
| Cost | 440 |
| **Chemical Y** | **₹** |
| Materials consumed | 440 |
| Direct Labour | 120 |
| Variable overheads | 80 |
| Fixed overheads (₹4,00,000/25,000 units) | 16 |
| Cost | 656 |

## Question 41

Omega Ltd., has a normal wastage of 4% in the production process. During the year 2019-20, the Company used 12,000 MT of raw material costing ₹150 per MT. At the end of the year 630 MT of wastage was ascertained in stock. The accountant wants to know how this wastage is to be treated in the books.

You are required to compute the amount of normal and abnormal loss and treatment thereof in line with AS 2 "Valuation of inventories".

*(5 Marks) (MTP, May 2020)*

**Answer:**

As per para AS 2 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

**Amount of Normal Loss and Abnormal Loss:**

| | |
|---|---|
| Material used | 12,000 MT @ ₹ 150 = ₹ 18,00,000 |
| Normal Loss (4% of 12,000 MT) | 480 MT |
| Net quantity of material | 11,520MT |
| Abnormal Loss in quantity | 150 MT (630 MT less 480 MT) |
| Abnormal Loss | ₹ 23,437.50 [150 units @ ₹ 156.25 (₹18,00,000/11,520)] |

Amount of ₹ 23,437.50 will be charged to the Profit and Loss statement.

## Question 42

Mr. Jatin gives the following information relating to the items forming part of the inventory as on 31.03.2019. His enterprise produces product P using Raw Material X.

(i) 900 units of Raw Material X (purchases @ ₹ 100 per unit). Replacement cost of Raw Material X as on 3103.2019 is ₹ 80 per unit

(ii) 400 units of partly finished goods in the process of producing P. Cost incurred till date is ₹ 245 per unit. These units can be finished next year by incurring additional cost of ₹ 50 per unit.

(iii) 800 units of Finished goods P and total cost incurred is ₹ 295 per unit.

Expected selling price of product P is ₹280 per unit, subject to a payment of 5% brokerage on selling price.

Determine how each item of inventory will be valued as on 31.03.2019. Also calculate the value of total Inventory as on 31.03.2019.

(*5 marks*)

**Answer**

As per AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. In the given case, selling price of product P is ₹ 266 and total cost per unit for production is ₹ 295.

Hence the valuation will be done as under:

(i) 900 units of raw material X will be written down to replacement cost as market value of finished product is less than its cost, hence valued at ₹ 80 per unit.

(ii) 400 units of partly finished goods will be valued at 216 per unit i.e., lower of cost (₹ 245) or Net realizable value ₹ 216 (Estimated selling price ₹ 266 per unit less additional cost of ₹ 50).

(iii) 800 units of finished product P will be valued at NRV of ₹ 266 per unit since it is lower than cost ₹ 295.

**Valuation of Total Inventory as on 31.03.2019:**

| | ***Units*** | ***Cost (₹)*** | ***NRV/Replacement cost*** | ***Value = units x cost or NRV whichever is less (₹)*** |
|---|---|---|---|---|
| Raw material X | 900 | 100 | 80 | 72,000 |
| Partly finished goods | 400 | 245 | 216 | 86,400 |
| Finished goods P | 800 | 295 | 266 | 2,12,800 |
| Value of Inventory | | | | 3,71,200 |

## Question 43

(i) "In determining the cost of inventories, it is appropriate to exclude certain costs and recognize them as expenses in the period in which they are incurred". Provide examples of such costs as per AS 2 'Valuation of Inventories'.

(*RTP May 2022*)

(ii) X Limited purchased goods at the cost of ₹ 40 lakhs in October, 2020. Till March, 2021, 75% of the stocks were sold. The company wants to disclose closing stock at ₹ 10 lakhs. The expected sale value is ₹ 11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct value of closing stock to be disclosed as at 31.3.2021.

(*5 Marks*)

**Answer**

**(i)** As per AS 2 'Valuation of Inventories', certain costs are excluded from the cost of the inventories and are recognized as expenses in the period in which incurred. Examples of such costs are:

(a) abnormal amount of wasted materials, labour, or other production costs;

(b) storage costs, unless those costs are necessary in the production process prior to a further production stage;

(c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and

(d) selling and distribution costs.

**(ii)** As per AS 2 "Valuation of Inventories", the inventories are to be valued at lower of cost or net realizable value. In this case, the cost of inventory is ₹ 10 lakhs. The net realizable value is 11,00,000 × 90% = ₹ 9,90,000. So, the stock should be valued at ₹ 9,90,000.

## Question 44

Joy Ltd. purchased 20,000 kilograms of Raw Material @ ₹20 per kilogram during the year 2020-21. They have furnished you with the following further information for the year ended 31st March, 2021:

| Particulars | Units | Amount (₹) |
|---|---|---|
| Opening Inventory: | | |
| Finished Goods | 2,000 | 1,00,000 |
| Raw Materials | 2,200 | 44,000 |
| Direct Labour | | 3,06,000 |
| Fixed Overheads | | 3,00,000 |
| Sales | 20,000 | 11,20,000 |
| Closing Inventory: | | |
| Finished Goods | 2,400 | |
| Raw Materials | 1,800 | |

The plant has a capacity to produce 30,000 Units of finished product per annum. However, the actual production of finished products during the year 2020-21 was 20,400 Units. Due to a fall in the market demand, the price of the finished goods in which the raw material has been utilized is expected to be sold @ ₹40 per unit. The replacement cost of the raw material was ₹19 per kilogram.

You are required to ascertain the value of closing inventory as at 31st March, 2021 as per AS 2.

(*5 Marks*)

## Similar Question

## Question 44A

SM Enterprises is a leading distributor of petrol. A detail inventory of petrol in hand is taken when the books are closed at the end of each month. For the end month of June 2021 following information is available:

(i) Sales for the month of June 2021 was ₹ 30,40,000.
(ii) General overheads cost ₹ 4,00,000.
(iii) Inventory at beginning 10,000 litres @ ₹ 92 per litre.
(iv) Purchases - June 1 2021, 20,000 litres @ ₹ 90 per litre, June 30 2021, 10,000 litres @ ₹ 95 per litre.
(v) Closing inventory 13,000 litres.

You are required to compute the following by FIFO method as per AS 2:

(i) Value of Inventory on 30th June, 2021.
(ii) Amount of cost of goods sold for June, 2021.
(iii) Profit/Loss for the month of June, 2021. (*Question Paper, May 2022*) (*5 Marks*)

## Question 45

The inventory of Rich Ltd. as on 31st March, 2020 comprises of Product – A: 200 units and Product – B: 800 units.

Details of cost for these products are:

Product – A: Material cost, wages cost and overhead cost of each unit are ₹ 40, ₹ 30 and ₹ 20 respectively, Each unit is sold at ₹ 110, selling expenses amounts to 10% of selling costs.

Product – B: Material cost and wages cost of each unit are ₹ 45 and ₹ 35 respectively and normal selling rate is ₹ 150 each, however due to defect in the manufacturing process 800 units of Product-B were expected to be sold at ₹ 70.

You are requested to value closing inventory according to AS 2 after considering the above.

**Answer**

According to AS 2 'Valuation of Inventories', inventories should be valued at the lower of cost and net realizable value.

**Product – A**

| | | |
|---|---|---|
| Material cost | ₹ 40 x 200 = 8,000 | |
| Wages cost | ₹ 30 x 200 = 6,000 | |
| Overhead | ₹ 20 x 200 = 4,000 | |
| Total cost | | ₹ 18,000 |
| Realizable value [200 x (110-11)] | | ₹ 19,800 |
| Hence inventory value of Product -A | | ₹ 18,000 |

**Product – B**

| | | |
|---|---|---|
| Material cost | ₹ 45 x 800 = 36,000 | |
| Wages cost | ₹ 35 x 800 = 28,000 | |
| Total cost | | ₹ 64,000 |
| Realizable value (800 x 70) | | ₹ 56,000 |
| Hence inventory value of Product-B | | ₹ 56,000 |
| Total Value of closing inventory i.e. Product A + Product B (18,000+ 56,000) | | ₹ 74,000 |

## Question 46

| **Particulars** | | **Kg.** | **₹** |
|---|---|---|---|
| Opening Inventory: | Finished Goods | 1,000 | 25,000 |
| | Raw Materials | 1,100 | 11,000 |
| Purchases | | 10,000 | 1,00,000 |
| Labour | | | 76,500 |
| Overheads (Fixed) | | | 75,000 |
| Sales | | 10,000 | 2,80,000 |
| Closing Inventory: | Raw Materials | 900 | |
| | Finished Goods | 1200 | |

The expected production for the year was 15,000 kg of the finished product. Due to fall in market demand the sales price for the finished goods was ₹ 20 per kg and the replacement cost for the raw material was ₹ 9.50 per kg on the closing day. You are required to calculate the closing inventory as on that date.

[*RTP May 2020*]

**Answer**

**Calculation of cost for closing inventory**

| ***Particulars*** | ***₹*** |
|---|---|
| Cost of Purchase (10,200 x 10) | 1,02,000 |
| Direct Labour | 76,500 |
| Fixed Overhead $\frac{75{,}000 \times 10{,}200}{15{,}000}$ | 51,000 |
| Cost of Production | 2,29,500 |
| Cost of closing inventory per unit (2,29,500/10,200) | ₹ 22.50 |
| Net Realisable Value per unit | ₹ 20.00 |

Since net realisable value is less than cost, closing inventory will be valued at ₹ 20.

As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacement cost i.e. ₹ 9.50.

| | |
|---|---|
| Therefore, value of closing inventory: Finished Goods (1,200 x 20) ₹ | 24,000 |
| Raw Materials (900 x 9.50) | ₹ 8,550 |
| | ₹ 32,550 |

## Question 47

"In determining the cost of inventories, it is appropriate to exclude certain costs and recognise them as expenses in the period in which they are incurred". Provide examples of such costs as per AS 2 (Revised) 'Valuation of Inventories'.

(*Study Material*)

**Answer**

As per AS 2 (Revised) 'Valuation of Inventories', certain costs are excluded from the cost of the inventories and are recognised as expenses in the period in which incurred. Examples of such costs are:

(a) abnormal amount of wasted materials, labour, or other production costs;

(b) storage costs, unless those costs are necessary in the production process prior to a further production stage;

(c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and selling and distribution costs.

## Question 48

Capital Cables Ltd., has a normal wastage of 4% in the production process. During the year 20X1-20X2 the Company used 12,000 MT of raw material costing ₹ 150 per MT. At the end of the year 630 MT of wastage was in stock. The accountant wants to know how this wastage is to be treated in the books. Explain in the context of AS 2 (Revised) the treatment of normal loss and abnormal loss and also find out the amount of abnormal loss, if any.

(*Study Material*)

**Answer**

As per AS 2 (Revised) 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

Amount of Abnormal Loss:

| | |
|---|---|
| Material used | 12,000 MT @ ₹150 = ₹18,00,000 |
| Normal Loss (4% of 12,000 MT) | 480 MT |
| Net quantity of material | 11,520 MT |
| Abnormal Loss in quantity | 150 MT |
| Abnormal Loss | ₹ 23,437.50 [150 units @ ₹ 156.25 (₹ 18,00,000/11,520)] |

Amount ₹ 23,437.50 will be charged to the Statement of Profit and Loss.

## Question 49

Mr. Mehul gives the following information relating to items forming part of inventory as on 31-3-20X1. His factory produces Product X using Raw material A.

**(i)** 600 units of Raw material A (purchased @ ₹ 120). Replacement cost of raw material A as on 31-3-20X1 is ₹ 90 per unit.

**(ii)** 500 units of partly finished goods in the process of producing X and cost incurred till date ₹ 260 per unit. These units can be finished next year by incurring additional cost of ₹ 60 per unit.

**(iii)** 1500 units of finished Product X and total cost incurred ₹ 320 per unit. Expected selling price of Product X is ₹ 300 per unit.

Determine how each item of inventory will be valued as on 31-3-20X1. Also calculate the value of total inventory as on 31-3-20X1.

(*Study Material*)

**Answer**

As per AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value. In the given case, selling price of product X is ₹ 300 and total cost per unit for production is ₹ 320.

Hence the valuation will be done as under:

(i) 600 units of raw material will be written down to replacement cost as market value of finished product is less than its cost, hence valued at ₹ 90 per unit.

(ii) 500 units of partly finished goods will be valued at 240 per unit i.e. lower of cost (₹ 260) or Net realisable value ₹ 240 (Estimated selling price ₹ 300 per unit less additional cost of ₹ 60).

(iii) 1,500 units of finished product X will be valued at NRV of ₹ 300 per unit since it is lower than cost ₹ 320 of product X.

**Valuation of Total Inventory as on 31.03.20X1:**

| | ***Units*** | ***Cost (₹)*** | ***NRV/ Replacement cost*** | ***Value = units x cost or NRV whichever is less (₹)*** |
|---|---|---|---|---|
| Raw material A | 600 | 120 | 90 | 54,000 |
| Partly finished goods | 500 | 260 | 240 | 1,20,000 |
| Finished goods X | 1,500 | 320 | 300 | 4,50,000 |
| Value of Inventory | | | | 6,24,000 |

## Question 50

Mr. Mehul gives the following information relating to items forming part of inventory as on 31-3-2019. His factory produces Product X using Raw material A.

(i) 600 units of Raw material A (purchased @ ₹120). Replacement cost of raw material A as on 31-3-2019 is ₹90 per unit.

(ii) 500 units of partly finished goods in the process of producing X and cost incurred till date ₹260 per unit. These units can be finished next year by incurring additional cost of ₹60 per unit.

(iii) 1500 units of finished Product X and total cost incurred ₹320 per unit. Expected selling price of Product X is ₹300 per unit.

Determine how each item of inventory will be valued as on 31-3-2019. Also calculate the value of total inventory as on 31-3-2019.

[*MTP October, 2019, 5 marks*]

**Answer**

As per AS 2 "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. In the given case, selling price of product X is ₹ 300 and total cost per unit for production is ₹ 320.

Hence the valuation will be done as under:

(i) 600 units of raw material will be written down to replacement cost as market value of finished product is less than its cost, hence valued at ₹ 90 per unit.

(ii) 500 units of partly finished goods will be valued at 240 per unit i.e. lower of cost ₹320 (₹ 260 + additional cost ₹ 60) or Net estimated selling price or NRV i.e. ₹ 240 (Estimated selling price ₹ 300 per unit less additional cost of ₹ 60).

(iii) 1,500 units of finished product X will be valued at NRV of ₹ 300 per unit since it is lower than cost ₹ 320 of product X.

**Valuation of Total Inventory as on 31.03.2019:**

| | Units | Cost (₹) | NRV/Replacement cost | Value = units x cost or NRV whichever is less (₹) |
|---|---|---|---|---|
| Raw material A | 600 | 120 | 90 | 54,000 |
| Partly finished goods | 500 | 260 | 240 | 1,20,000 |
| Finished goods X | 1,500 | 320 | 300 | 4,50,000 |
| Value of Inventory | | | | 6,24,000 |

## Question 51

Mr. Rakshit gives the following information relating to items forming part of inventory as on **31st** March, 2019. His factory produces product X using raw material A.

(i) 800 units of raw material A (purchased @ ₹140 per unit). Replacement cost of raw material A as on 31st March, 2019 is ₹190 per unit.

(ii) 650 units of partly finished goods in the process of producing X and cost incurred till date ₹310 per unit. These units can be finished next year by incurring additional cost of ₹50 per unit.

(iii) 1,800 units of finished product X and total cost incurred ₹360 per unit.
Expected selling price of product X is ₹350 per unit.

In the context of AS-2, determine how each item of inventory will be valued as on 31st March, 2019. Also, calculate the value of total inventory as on 31st March, 2019.

(*November 2019*) (*5 Marks*)

**Answer**

As per AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. In the given case, selling price of product X is ₹ 350 and total cost per unit for production is ₹ 360.

Hence the valuation will be done as under:

(i) 800 units of raw material will be valued at cost 140.

(ii) 650 units of partly finished goods will be valued at 300 per unit* i.e. lower of cost (₹ 310) or Net realizable value ₹ 300 (Estimated selling price ₹ 350 per unit less additional cost of ₹ 50).

(iii) 1,800 units of finished product X will be valued at NRV of ₹ 350 per unit since it is lower than cost ₹ 360 of product X.

**Valuation of Total Inventory as on 31.03.2019:**

| | Units | Cost (₹) | NRV/ Replacement cost ₹ | Value = units x cost or NRV whichever is less (₹) | ₹ |
|---|---|---|---|---|---|
| Raw material A | 800 | 140 | 190 | 1,12,000 | (800 x 140) |
| Partly finished goods | 650 | 310 | 300 | 1,95,000 | (650 x 300) (1,800 |
| Finished goods X | 1,800 | 60 | 350 | 6,30,000 | x 350) |
| Value of Inventory | | | | 9,37,000 | |

*It has been assumed that the partly finished unit cannot be sold in semi-finished form and its NRV is zero without processing it further.

## Question 52

In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input is ₹ 1,000. The entire quantity of waste and finished output is in stock at the year end. State with reference to Accounting Standard, how will you value the inventories in this case? What will be treatment for normal and abnormal waste?

*(MTP April, 2022) (5 Marks)*

**Answer**

As per AS 2 (Revised), abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred.

In this case, normal waste is 250 MT and abnormal waste is 50 MT. The cost of 250 MT will be included in determining the cost of inventories (finished goods) at the year end. The cost of abnormal waste (50 MT x 1,052.6315 = ₹ 52,632) will be charged to the profit and loss statement.

Cost per MT (Normal Quantity of 4,750 MT) = 50,00,000 / 4,750 = ₹ 1,052.6315 Total value of inventory = 4,700 MT x ₹ 1,052.6315 = ₹ 49,47,368.

## Question 53

From the following information provided by XYZ Limited you are required to compute the closing inventory:

| | |
|---|---|
| **Raw Material P** | |
| Closing balance | 600 units |
| | ₹per unit |
| Cost price including GST | 250 |
| Input tax credit available | 20 |
| Freight inward | 30 |
| Handling charges | 15 |
| Replacement cost | 180 |
| **Finished goods Q** | |
| Closing balance | 1500 units |
| | ₹per unit |
| Material consumed | 250 |
| Direct labour | 70 |
| Direct overhead | 30 |

Total fixed overhead for the year was ₹ 3,00,000 on a normal capacity of 30,000 units while actual production has been of 25,000 units.

Calculate the value of closing stock, when

(i) Net realizable value of the finished good Q is ₹ 450 per unit.

(ii) Net Realizable value of the Finished Good Q is ₹ 340 per unit.

*(MTP, October 2021) (5 Marks)*

**Answer**

**(i) When Net Realizable Value of the Finished Good Q is ₹ 450 per unit Value of Closing Stock:**

| | ***Valuation Base*** | ***Qty.*** | ***Rate (₹)*** | ***Amount (₹)*** |
|---|---|---|---|---|
| Raw Material P | Cost | 600 | 275 | 1,65,000 |
| Finished Good Q | Cost | 1,500 | 360 | 5,40,000 |
| Total value of closing stock | | | | 7,05,000 |

**(ii) When Net Realizable Value of the Finished Good Q is ₹ 340 per unit**

Since NRV of finished goods Q is less than its cost i.e. ₹ 360 (Refer W.N.), raw material P is to be valued at replacement cost and finished goods is to be valued at NRV.

**Value of Closing Stock:**

| | ***Valuation Base*** | ***Qty.*** | ***Rate (₹)*** | ***Amount (₹)*** |
|---|---|---|---|---|
| Raw material P | Replacement cost | 600 | 180 | 1,08,000 |
| Finished good Q | Net Realisable Value | 1,500 | 340 | 5,10,000 |
| Total value of closing stock | | | | 6,18,000 |

**Working Note:**

**Statement showing calculation of cost of raw material P and finished good Q**

| **Raw Material P** | ***₹*** |
|---|---|
| Cost Price (250-20) | 230 |
| *Add*: Freight Inward | 30 |
| Handling charges | 15 |
| Cost | 275 |
| **Finished Goods Q** | ***₹*** |
| Materials consumed | 250 |
| Direct Labour | 70 |
| Variable overheads | 30 |
| Fixed overheads (₹ 3,00,000/30,000 units) | 10 |
| | 360 |

## Question 54

On 31st March 2020, a business firm finds that cost of a partly finished unit on that date is ₹ 430. The unit can be finished in 2020-21 by an additional expenditure of ₹ 310. The finished unit can be sold for ₹ 750 subject to payment of 2% brokerage on selling price. The firm seeks your advice regarding the amount at which the unfinished unit should be valued as at 31st March, 2020 for preparation of final accounts. Assume that the partly finished unit cannot be sold in semi-finished form and its NRV is zero without processing it further.

(*RTP, November 2021*)

**Answer**

**Valuation of unfinished unit**

| | ₹ |
|---|---|
| Net selling price | 750 |
| *Less*: Estimated cost of completion | (310) |
| | 440 |
| *Less*: Brokerage (2 % of 750) | (15) |
| Net Realisable Value | 425 |
| Cost of inventory | 430 |
| Value of inventory (Lower of cost and net realisable value) | 425 |

# AS 3: Cash Flow Statement

## Question 55

*Classify the following activities as (a) Operating Activities, (b) Investing Activities, (c) Financing Activities (d) Cash Equivalents.*

(a) *Purchase of Machinery.*

(b) *Proceeds from issuance of equity share capital*

(c) *Cash Sales.*

(d) *Proceeds from long-term borrowings.*

(e) *Proceeds from Trade receivables.*

(f) *Cash receipts from Trade receivables.*

(g) *Trading Commission received.*

(h) *Purchase of investment.*

(i) *Redemption of Preference Shares.*

(j) *Cash Purchases.*

(k) *Proceeds from sale of investment*

(l) *Purchase of goodwill.*

(m) *Cash paid to suppliers.*

(n) *Interim Dividend paid on equity shares.*

(o) *Wages and salaries paid.*

(p) *Proceed from sale of patents.*

(q) *Interest received on debentures held as investment.*

(r) *Interest paid on Long-term borrowings.*

(s) *Office and Administration Expenses paid*

(t) *Manufacturing Overheads paid.*

(u) *Dividend received on shares held as investments.*

(v) *Rent Received on property held as investment.*

(w) *Selling and distribution expense paid.*

(x) *Income tax paid*

(y) *Dividend paid on Preference shares.*

(z) *Underwritings Commission paid.*

(aa) *Rent paid.*

(bb) *Brokerage paid on purchase of investments.*

(cc) *Bank Overdraft*

(dd) *Cash Credit*

(ee) *Short-term Deposits*

*(ff)* *Marketable Securities*

*(gg)* *Refund of Income Tax received.*

(*Study Material*)

**Answer**

(a) Operating Activities: c, e, f, g, j, m, o, s, t, w, x, aa & gg.

(b) Investing Activities: a, h, k, l, p, q, u, v, bb & ee.

(c) Financing Activities: b, d, i, n, r, y, z, cc & dd.

(d) Cash Equivalent: ff.

## Question 56

*X Ltd. purchased debentures of ₹ 10 lacs of Y Ltd., which are redeemable within three months. How will you show this item as per AS 3 while preparing cash flow statement for the year ended on 31st March, 20X1?*

(*Study Material*)

**Answer**

As per AS 3 on 'Cash flow Statement', cash and cash equivalents consists of cash in hand, balance with banks and short-term, highly liquid investments* If investment, of ₹ 10 lacs, made in debentures is for short-term period then it is an item of 'cash equivalents'.

However, if investment of ₹ 10 lacs made in debentures is for long-term period then as per AS 3, it should be shown as cash flow from investing activities.

## Question 57

*Classify the following activities as per AS 3 Cash Flow Statement:*

*(i)* *Interest paid by financial enterprise*

*(ii)* *Tax deducted at source on interest received from subsidiary company*

*(iii)* *Deposit with Bank for a term of two years*

*(iv)* *Insurance claim received towards loss of machinery by fire*

*(v)* *Bad debts written off*

(*Study Material*)

**Answer**

(i) Interest paid by financial enterprise

Cash flows from operating activities

(ii) TDS on interest received from subsidiary company

Cash flows from investing activities

(iii) Deposit with bank for a term of two years

Cash flows from investing activities

(iv) Insurance claim received against loss of fixed asset by fire

Extraordinary item to be shown as a separate heading under 'Cash flow from investing activities'

(v) Bad debts written off

It is a non-cash item which is adjusted from net profit/loss under indirect method, to arrive at net cash flow from operating activity.

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* *As per AS 3, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say three months or less from the date of acquisition.*

## Question 58

*Following is the cash flow abstract of Alpha Ltd. for the year ended 31st March, 20X1:*

**Cash Flow (Abstract)**

| *Inflows* | ₹ | *Outflows* | ₹ |
|---|---|---|---|
| *Opening balance:* | | *Payment for Account* | |
| *Cash* | *10,000* | *Payables* | *90,000* |
| *Bank* | *70,000* | *Salaries and wages* | *25,000* |
| *Share capital–shares issued* | *5,00,000* | *Payment of overheads* | *15,000* |
| *Collection on account of Trade Receivables* | *3,50,000* | *Property, plant and equipment acquired* | *4,00,000* |
| | | *Debentures redeemed* | *50,000* |
| *Sale of Property, plant and equipment* | *70,000* | *Bank loan repaid* | *2,50,000* |
| | | *Taxation* | *55,000* |
| | | *Dividends* | *1,00,000* |
| | | *Closing balance:* | |
| | | *Cash* | *5,000* |
| | | *bank* | *10,000* |
| | *10,00,000* | | *10,00,000* |

*Prepare Cash Flow Statement for the year ended 31st March, 20X1 in accordance with Accounting standard 3.*

(*Study Material*)

**Answer**

**Cash Flow Statement for the year ended 31.3.20X1**

| | ₹ | ₹ |
|---|---|---|
| **Cash flow from operating activities** | | |
| Cash received on account of trade receivables | 3,50,000 | |
| Cash paid on account of trade payables | (90,000) | |
| Cash paid to employees (salaries and wages) | (25,000) | |
| Other cash payments (overheads) | (15,000) | |
| Cash generated from operations | 2,20,000 | |
| Income tax paid | (55,000) | |
| Net cash generated from operating activities | | 1,65,000 |
| **Cash flow from investing activities** | | |
| Payment for purchase of Property, plant and equipment | (4,00,000) | |
| Proceeds from sale of Property, plant and equipment | 70,000 | |
| Net cash used in investment activities | | (3,30,000) |
| **Cash flow from financing activities** | | |
| Proceeds from issue of share capital | 5,00,000 | |
| Bank loan repaid | (2,50,000) | |
| Debentures redeemed | (50,000) | |
| Dividends paid | (1,00,000) | |
| Net cash used in financing activities | | 1,00,000 |
| Net decrease in cash and cash equivalents | | (65,000) |
| Cash and cash equivalents at the beginning of the year | | 80,000 |
| Cash and cash equivalents at the end of the year | | 15,000 |

## Question 59

*Prepare Cash Flow from Investing Activities of M/s. Creative Furnishings Limited for the year ended 31-3-20X1.*

| ***Particulars*** | ***₹*** |
|---|---|
| *Plant acquired by the issue of 8% Debentures* | *1,56,000* |
| *Claim received for loss of plant in fire* | *49,600* |
| *Unsecured loans given to subsidiaries* | *4,85,000* |
| *Interest on loan received from subsidiary companies* | *82,500* |
| *Pre-acquisition dividend received on investment made* | *62,400* |
| *Debenture interest paid* | *1,16,000* |
| *Term loan repaid* | *4,25,000* |
| *Interest received on investment* | *68,000* |
| *(TDS of ₹ 8,200 was deducted on the above interest)* | |
| *Book value of plant sold (loss incurred ₹ 9,600)* | *84,000* |

(*Study Material*)

**Answer**

**Cash Flow Statement from Investing Activities of**
**M/s Creative Furnishings Limited for the year ended 31-03-20X1**

| ***Cash generated from investing activities*** | **₹** | **₹** |
|---|---|---|
| Interest on loan received | 82,500 | |
| Pre-acquisition dividend received on investment made | 62,400 | |
| Unsecured loans given to subsidiaries | (4,85,000) | |
| Interest received on investments (gross value) | 76,200 | |
| TDS deducted on interest | (8,200) | |
| Sale of plant | 74,400 | |
| Cash used in investing activities (before extra ordinary item) | | (1,97,700) |
| Extraordinary claim received for loss of plant | | 49,600 |
| Net cash used in investing activities (after extra ordinary item) | | (1,48,100) |

***Note:***

1. Debenture interest paid and Term Loan repaid are financing activities and therefore not considered for preparing cash flow from investing activities.
2. Plant acquired by issue of 8% debentures does not amount to cash outflow, hence also not considered in the above cash flow statement.

# QUESTION BANK

## Question 60

Classify the following activities as (1) Operating Activities, (2) Investing Activities, (3) Financing Activities (4) Cash Equivalents.

(a) Proceeds from long-term borrowings.
(b) Proceeds from Trade receivables.
(c) Trading Commission received.
(d) Redemption of Preference Shares.
(e) Proceeds from sale of investment
(f) Interim Dividend paid on equity shares.
(g) Interest received on debentures held as investment.
(h) Dividend received on shares held as investments.
(i) Rent received on property held as investment.
(j) Dividend paid on Preference shares.
(k) Marketable Securities

[*RTP May 2020*]

**Answer**

Operating Activities: b, c.
Investing Activities: e, g, h, i.
Financing Activities: a, d, f, j.
Cash Equivalent: k.

## Question 61

What are the main features of the Cash Flow Statement?

(*Study Material*)

**Answer**

According to AS 3 on "Cash Flow Statement", cash flow statement deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise during the given period from operating, investing and financing activities. Cash flows from operating activities can be reported using either (a) the direct method, or (b) the indirect method. A cash flow statement when used in conjunction with the other financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency), and its ability to affect the amount and timing of cash flows in order to adapt to changing circumstances and opportunities.

## Question 62

Money Ltd., a non-financial company has the following entries in its Bank Account. It has sought your advice on the treatment of the same for preparing Cash Flow Statement.

**(i)** Loans and Advances given to the following and interest earned on them:
- **(1)** to suppliers
- **(2)** to employees
- **(3)** to its subsidiaries companies

**(ii)** Investment made in subsidiary Smart Ltd. and dividend received

**(iii)** Dividend paid for the year

**(iv)** TDS on interest income earned on investments made

**(v)** TDS on interest earned on advance given to suppliers Discuss in the context of AS 3 Cash Flow Statement.

(*Study Material*)

**Answer**

Treatment as per AS 3 'Cash Flow Statement'

(i) Loans and advances given and interest earned
- (1) to suppliers Cash flows from operating activities
- (2) to employees Cash flows from operating activities
- (3) to its subsidiary companies Cash flows from investing activities

(ii) Investment made in subsidiary company and dividend received
Cash flows from investing activities

(iii) Dividend paid for the year
Cash flows from financing activities

(iv) TDS on interest income earned on investments made
No cash inflow/cash outflow

(v) TDS on interest earned on advance given to suppliers
No cash inflow/cash outflow

## Question 63

From the following information of XYZ Limited, calculate cash and cash equivalent as on 31-03-20X2 as per AS-3.

| Particulars | Amount (₹) |
|---|---|
| Balance as per the Bank Statement | 25,000 |
| Cheque issued but not presented in the Bank | 15,000 |
| Short Term Investment in liquid equity shares of ABC Limited | 50,000 |
| Fixed Deposit created on 01-11-20X1 and maturing on15-04-20X2 | 75,000 |
| Short Term Investment in highly liquid Sovereign Debt Mutual fund on 01-03-20X2 (having maturity period of less than 3 months) | 1,00,000 |
| Bank Balance in a Foreign Currency Account in India<br>(Conversion Rate: On the day of deposit ₹ 69/USD as on 31-03-20X2 ₹ 70/USD) | $ 1,000 |

(*Study Material*)

**Answer**

**Computation of Cash and Cash Equivalents as on 31st March, 20X2**

| | ₹ |
|---|---|
| Cash balance with bank (₹ 25,000 less ₹ 15,000) | 10,000 |
| Short term investment in highly liquid sovereign debt mutual fund on 1.3.20X2 | 1,00,000 |
| Bank balance in foreign currency account ($1,000 x ₹ 70) | 70,000 |
| | 1,80,000 |

**Note:** Short term investment in liquid equity shares and fixed deposit will not be considered as cash and cash equivalents.

# AS 10: Property, Plant and Equipment

## Question 64

*Entity A, a supermarket chain, is renovating one of its major stores. The store will have more available space for in store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers. State whether the remodelling cost will be capitalised or not.*

(*Study Material*)

**Answer**

The expenditure in remodelling the store will create future economic benefits (in the form of 15% of increase in sales) and the cost of remodelling can be measured reliably, therefore, it should be capitalised.

## Question 65

*What happens if the cost of the previous part/inspection was/ was not identified in the transaction in which the item was acquired or constructed?*

(*Study Material*)

**Answer**

De-recognition of the carrying amount occurs regardless of whether the cost of the previous part/inspection was identified in the transaction in which the item was acquired or constructed.

## Question 66

*What will be your answer in the above question, if it is not practicable for an enterprise to determine the carrying amount of the replaced part/inspection?*

(*Study Material*)

**Answer**

It may use the cost of the replacement or the estimated cost of a future similar inspection as an indication of what the cost of the replaced part/existing inspection component was when the item was acquired or constructed.

## Question 67

*Entity A has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site. The following incremental costs will be incurred:*

1. *Setup costs of ₹ 5,00,000 to install machinery in the new location.*
2. *Rent of ₹ 15,00,000*
3. *Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.*

*Can these costs be capitalised into the cost of the new building?*

(*Study Material*)

**Answer**

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not to be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The costs to be incurred by the company are in the nature of costs of relocating or reorganising operations of the company and do not meet the requirement of AS 10 (Revised) and therefore, cannot be capitalised.

## Question 68

*Omega Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month. The machine was purchased at ₹ 1,58,00,000 and ₹ 50,000 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹ 30,000 to supervise machinery installation at the factory site. You are required to ascertain the amount at which the Machinery should be capitalized.*

(*Study Material*)

**Answer**

| Particulars | | ₹ |
|---|---|---|
| Purchase Price | Given | 1,58,00,000 |
| *Add:* Site Preparation Cost | Given | 1,40,000 |
| Technician's Salary | Specific/Attributable overheads for 3 months (45,000 x3) | 1,35,000 |
| Initial Delivery Cost | Transportation | 50,000 |
| Professional Fees for Installation | Architect's Fees | 30,000 |
| Total Cost of Machinery | | 1,61,55,000 |

## Question 69

*Entity A, which operates a major chain of supermarkets, has acquired a new store location. The new location requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the supermarket will be closed.*

*Management has prepared the budget for this period including expenditure related to construction and remodelling costs, salaries of staff who will be preparing the store before its opening and related utilities costs. What will be the treatment of such expenditures?*

(*Study Material*)

**Answer**

Management should capitalise the costs of construction and remodelling the supermarket, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management. The supermarket cannot be opened without incurring the remodelling expenditure, and thus the expenditure should be considered part of the asset.

However, if the cost of salaries, utilities and storage of goods are in the nature of operating expenditure that would be incurred if the supermarket was open, then these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management and should be expensed.

## Question 70

*An amusement park has a 'soft' opening to the public, to trial run its attractions. Tickets are sold at a 50% discount during this period and the operating capacity is 80%. The official opening day of the amusement park is three months later. Management claim that the soft opening is a trial run necessary for the amusement park to be in the condition capable of operating in the intended manner. Accordingly, the net operating costs incurred should be capitalised. Comment.*

(*Study Material*)

**Answer**

The net operating costs should not be capitalised, but should be recognised in the Statement of Profit and Loss.

Even though it is running at less than full operating capacity (in this case 80% of operating capacity), there is sufficient evidence that the amusement park is capable of operating in the manner intended by management. Therefore, these costs are specific to the start-up and, therefore, should be expensed as incurred.

## Question 71

*Entity A exchanges land with a book value of ₹ 10,00,000 for cash of ₹ 20,00,000 and plant and machinery valued at ₹ 25,00,000. What will be the measurement cost of the assets received. (Consider that the transaction has commercial substance)?*

(*Study Material*)

**Answer**

Since the transaction has commercial substance the plant and machinery would be recorded at ₹ 25,00,000, which is equivalent to the fair value of the land of₹ 45,00,000 less the cash received of ₹ 20,00,000.

## Question 72

*Entity A exchanges car X with a book value of ₹ 13,00,000 and a fair value of₹ 13,25,000 for cash of ₹ 15,000 and car Y which has a fair value of ₹ 13,10,000. The transaction lacks commercial substance as the company's cash flows are not expected to change as a result of the exchange. It is in the same position as it was before the transaction. What will be the measurement cost of the assets received?*

(*Study Material*)

**Answer**

The entity recognises the assets received at the book value of car X. Therefore, it recognises cash of ₹15,000 and car Y as PPE with a carrying value of ₹ 12,85,000.

## Question 73

*Entity A is a large manufacturing group. It owns a number of industrial buildings, such as factories and warehouses and office buildings in several capital cities. The industrial buildings are located in industrial zones, whereas the office buildings are in central business districts of the cities. Entity A's management want to apply the revaluation model as per AS 10 (Revised) to the subsequent measurement of the office buildings but continue to apply the historical cost model to the industrial buildings.*

*State whether this is acceptable under AS 10 (Revised) or not with reasons?*

(*Study Material*)

**Answer**

Entity A's management can apply the revaluation model only to the office buildings. The office buildings can be clearly distinguished from the industrial buildings in terms of their function, their nature and their general location.AS 10 (Revised) permits assets to be revalued on a class by class basis.

The different characteristics of the buildings enable them to be classified as different PPE classes. The different measurement models can, therefore, be applied to these classes for subsequent measurement.

However, all properties within the class of office buildings must be carried at revalued amount.

## Question 74

*Entity A has a policy of not providing for depreciation on PPE capitalised in the year until the following year, but provides for a full year's depreciation in the year of disposal of an asset. Is this acceptable?*

(*Study Material*)

**Answer**

The depreciable amount of a tangible fixed asset should be allocated on a systematic basis over its useful life. The depreciation method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

Useful life means the period over which the asset is expected to be available for use by the entity. Depreciation should commence as soon as the asset is acquired and is available for use. Thus, the policy of Entity A is not acceptable.

## Question 75

*Entity A purchased an asset on 1st January 20X1 for ₹ 1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil.*

*On 1st January 20X5, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years.*

*Calculate the amount of depreciation for each year, if company charges depreciaion on Straight Line basis.*

(*Study Material*)

**Answer**

The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e (1,00,000/10 years).

On 1st January 20X5, the asset's net book value is [1,00,000 – (10,000 x 4)] ₹ 60,000.

The remaining useful life is 4 years.

The company should amend the annual provision for depreciation to charge the unamortised cost over the revised remaining life of four years.

Consequently, it should charge depreciation for the next 4 years at ₹ 15,000 per annum i.e. (60,000 / 4 years).

**Note:** Depreciation is recognised even if the Fair value of the Asset exceeds its Carrying Amount. Repair and maintenance of an asset do not negate the need to depreciate it.

## Question 76

*Entity B constructs a machine for its own use. Construction is completed on 1st November 20X1 but the company does not begin using the machine until 1st March 20X2. Comment.*

(*Study Material*)

**Answer**

The entity should begin charging depreciation from the date the machine is ready for use – that is, 1st November 20X1. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.

The residual value of an asset may increase to an amount equal to or greater than its carrying amount. If it does, depreciation charge of the asset is zero unless and until its residual value subsequently decreases to an amount below its carrying amount.

## Question 77

*A property costing ₹ 10,00,000 is bought in 20X1. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 20 years.*

*The estimated residual value in 20 years' time, based on 20X1 prices, is:*

*Case (a) ₹ 10,00,000*

*Case (b) ₹ 9,00,000.*

*Calculate the amount of depreciation.*

(*Study Material*)

**Answer**

**Case (a)**

The company considers that the residual value, based on prices prevailing at thebalance sheet date, will equal the cost.

There is, therefore, no depreciable amount and depreciation is correctly zero.

**Case (b)**

The company considers that the residual value, based on prices prevailing at the balance sheet date, will be ₹9,00,000 and the depreciable amount is, therefore,₹ 1,00,000.

Annual depreciation (on a straight-line basis) will be ₹ 5,000 [{10,00,000 – 9,00,000}÷ 20].

## Question 78

*Entity B manufactures industrial chemicals and uses blending machines in the production process. The output of the blending machines is consistent from year to year and they can be used for different products.*

*However, maintenance costs increase from year to year and a new generation of machines with significant improvements over existing machines is available every 5 years. Suggest the depreciation method to the management.*

(*Study Material*)

**Answer**

The straight-line depreciation method should be adopted, because the production output is consistent from year to year.

Factors such as maintenance costs or technical obsolescence should be considered in determining the blending machines' useful life.

## Question 79

*Entity A carried plant and machinery in its books at ₹ 2,00,000. These were destroyed in a fire. The assets were insured 'New for old' and were replaced by the insurance company with new machines that cost ₹ 20,00,000. The machines were acquired by the insurance company and the company did not receive ₹ 20,00,000 as cash compensation. State, how Entity A should account for the same?*

(*Study Material*)

**Answer**

Entity A should account for a loss in the Statement of Profit and Loss on de- recognition of the carrying value of plant and machinery in accordance with AS 10 (Revised).

Entity A should separately recognise a receivable and a gain in the income statement resulting from the insurance proceeds under AS 29 (Revised)* once receipt is virtually certain. The receivable should be measured at the fair value of assets that will be provided by the insurer.

# QUESTION BANK

## Question 80

Neon Enterprise operates a major chain of restaurants located in different cities. The company has acquired a new restaurant located at Chandigarh. The new restaurant requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the restaurant will be closed.

Management has prepared the following budget for this period—

| | |
|---|---|
| Salaries of the staff engaged in preparation of restaurant before its opening | ₹7,50,000 |
| Construction and remodelling cost of restaurant | ₹30,00,000 |

Explain the treatment of these expenditures as per the provisions of AS 10 "Property, Plant and Equipment".

(*November 2018*) (*5 Marks*)

**Answer:**

As per provisions of AS 10, any cost directly attributable to bring the assets to the location and conditions necessary for it to be capable of operating in the manner indicated by the management are called directly attributable costs and would be included in the costs of an item of PPE.

Management of Neon Enterprise should capitalize the costs of construction and remodelling the restaurant, because they are necessary to bring the restaurant to the condition necessary for it to be capable of operating in the manner intended by management. The restaurant cannot be opened without incurring the construction and remodelling expenditure amounting ₹ 30,00,000 and thus the expenditure should be considered part of the asset.

However, the cost of salaries of staff engaged in preparation of restaurant ₹ 7,50,000 before its opening are in the nature of operating expenditure that would be incurred if the restaurant was open and these costs are not necessary to bring the restaurant to the conditions necessary for it to be capable of operating in the manner intended by management. Hence, ₹ 7,50,000 should be expensed.

## Question 81

Preet Ltd. is installing a new plant at its production facility. It has incurred these costs:

| | | |
|---|---|---|
| 1. | Cost of the plant (cost per supplier's invoice plus taxes) | ₹ 50,00,000 |
| 2. | Initial delivery and handling costs | ₹ 4,00,000 |
| 3. | Cost of site preparation | ₹ 12,00,000 |
| 4. | Consultants used for advice on the acquisition of the plant | ₹ 14,00,000 |
| 5. | Interest charges paid to supplier of plant for deferred credit | ₹ 4,00,000 |
| 6. | Estimated dismantling costs to be incurred after 7 years | ₹ 6,00,000 |
| 7. | Operating losses before commercial production | ₹ 8,00,000 |

Please advise Preet Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised).

(*RTP May 2019*)

**Answer:**

According to AS 10 (Revised), these costs can be capitalised:

| | | |
|---|---|---|
| 1. | Cost of the plant | ₹ 50,00,000 |
| 2. | Initial delivery and handling costs | ₹ 4,00,000 |
| 3. | Cost of site preparation | ₹ 12,00,000 |
| 4. | Consultants' fees | ₹14,00,000 |
| 5. | Estimated dismantling costs to be incurred after 7 years | ₹ 6,00,000 |
| | | ₹ 86,00,000 |

**Note:** Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 4,00,000 and operating losses before commercial production amounting to ₹ 8,00,000 are not regarded as directly attributable costs and thus cannot be capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

## Question 82

ABC Ltd. is installing a new plant at its production facility. It provides you the following information:

| | ₹ |
|---|---|
| Cost of the plant (cost as per supplier's invoice) | 31,25,000 |
| Estimated dismantling costs to be incurred after 5 years | 2,50,000 |
| Initial Operating losses before commercial production | 3,75,000 |
| Initial delivery and handling costs | 1,85,000 |
| Cost of site preparation | 4,50,000 |
| Consultants used for advice on the acquisition of the plant | 6,50,000 |

You are required to compute the costs that can be capitalised for plant by ABC Ltd., in accordance with AS 10: Property, Plant and Equipment.

(*RTP November 2018*)

**Answer:**

According to AS 10 on Property, Plant and Equipment, the costs which will be capitalized by ABC Ltd.:

| | ₹ |
|---|---|
| Cost of the plant | 31,25,000 |
| Initial delivery and handling costs | 1,85,000 |
| Cost of site preparation | 4,50,000 |
| Consultants' fees | 6,50,000 |
| Estimated dismantling costs to be incurred after 5 years | 2,50,000 |
| Total cost of Plant | 46,60,000 |

**Note**: Operating losses before commercial production amounting to ₹3,75,000 will not be capitalized as per AS 10. They should be written off to the Statement of Profit and Loss in the period they are incurred.

## Question 83

In the year 2016-17, an entity has acquired a new freehold building with a useful life of 50 years for ₹ 90,00,000. The entity desires to calculate the depreciation charge per annum using a straight-line method. It has identified the following components (with no residual value of lifts & fixtures at the end of their useful life) as follows:

| Component | Useful life (Years) | Cost |
|---|---|---|
| Land | Infinite | ₹ 20,00,000 |
| Roof | 25 | ₹ 10,00,000 |
| Lifts | 20 | ₹ 5,00,000 |
| Fixtures | 10 | ₹ 5,00,000 |
| Remainder of building | 50 | ₹ 50,00,000 |
| | | ₹ 90,00,000 |

You are required to calculate depreciation for the year 2016-17 as per componentization method.

(*RTP May 2018*)

**Answer:**

**Statement showing amount of depreciation as per Componentization Method**

| Component | Depreciation (Per annum) (₹) |
|---|---|
| Land | Nil |
| Roof | 40,000 |
| Lifts | 25,000 |
| Fixtures | 50,000 |
| Remainder of Building | 1,00,000 |
| | 2,15,000 |

**Note**: When the roof requires replacement at the end of its useful life the carrying amount will be nil. The cost of replacing the roof should be recognized as a new component.

## Question 84

Mohan Ltd. purchased an asset on 1st January 2013 for ₹ 5,00,000 and the asset had an estimated useful life of 5 years and a residual value of nil. On 1st January 2017, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years.

You are required to compute the amount of depreciation for each year, if company charges depreciation on Straight Line basis.

(*MTP April 2019*) (*5 Marks*)

**Answer:**

The entity has charged depreciation using the straight-line method at ₹ 1,00,000 per annum i.e (5,00,000/5 years). On 1st January 2017, the asset's net book value is [5,00,000–(1,00,000 x 4)] ₹ 1,00,000. The remaining useful life is 4 years. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of four years. Consequently, it should charge depreciation for the next 4 years at ₹ 25,000 per annum i.e. (1,00,000/4 years).

## Question 85

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom -made machine amounting to ₹ 4,00,000. As on 31st March, 2018 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'.

Explain the treatment of machine in the books of ABC Ltd.

(*MTP August, 2018*) (*5 Marks*)

**Answer:**

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹4,00,000 payable to XYZ Ltd.

When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense.

Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2018.

## Question 86

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

| | |
|---|---|
| Cost of the plant (cost per supplier's invoice plus taxes) | ₹ 25,00,000 |
| Initial delivery and handling costs | ₹ 2,00,000 |
| Cost of site preparation | ₹ 6,00,000 |
| Consultants used for advice on the acquisition of the plant | ₹ 7,00,000 |
| Interest charges paid to supplier of plant for deferred credit | ₹ 2,00,000 |
| Estimated dismantling costs to be incurred after 7 years | ₹ 3,00,000 |
| Operating losses before commercial production | ₹ 4,00,000 |

Please advise ABC Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised).

(*MTP August, 2018*) (*5 Marks*)

**Answer:**

**According to AS 10 (Revised), the following costs can be capitalized:**

| | |
|---|---|
| Cost of the plant | ₹ 25,00,000 |
| Initial delivery and handling costs | ₹ 2,00,000 |
| Cost of site preparation | ₹ 6,00,000 |
| Consultants' fees | ₹ 7,00,000 |
| Estimated dismantling costs to be incurred after 7 years | ₹ 3,00,000 |
| | ₹ 43,00,000 |

*Note*: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 2,00,000 and operating losses before commercial production amounting to ₹ 4,00,000 are not regarded as directly attributable costs and thus cannot be capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

## Question 87

Mohan Ltd. has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site.

The following incremental costs will be incurred:

Setup costs of ₹ 5,00,000 to install machinery in the new location.

Rent of ₹ 15,00,000.

Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.

Mohan Ltd. wants to seek your guidance as whether these costs can be capitalized into the cost of the new building. You are required to advise in line with AS 10 “Property, Plant and Equipment”.

(*MTP October, 2018*) (*5 Marks*)

**Answer:**

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

The costs to be incurred by the company are in the nature of costs of reducing or reorganizing the operations of the accompany. These costs do not meet that requirement of AS 10 “Property, Plant and Equipment” and cannot, therefore, be capitalized.

## Question 88

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom -made machine amounting to ₹ 4,00,000. As on 31st March, 2018 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is ‘NIL’.

Show the treatment of machine in the books of ABC Ltd.

(*MTP October, 2018*) (*5 Marks*)

**Answer:**

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹4,00,000 payable to XYZ Ltd. When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense. Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2018.

## Question 89

Mohan Ltd. has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site.

The following incremental costs will be incurred:

Setup costs of ₹ 5,00,000 to install machinery in the new location.

Rent of ₹ 15,00,000

Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.

You are required to examine in line with AS 10 "Property, Plant and Equipment" whether these costs can be capitalized into the cost of the new building.

(*MTP March 2018*) (*5 Marks*)

**Answer**:

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

The costs to be incurred by the company are in the nature of costs of reducing or reorganizing the operations of the accompany. These costs do not meet that requirement of AS 10 "Property, Plant and Equipment" and cannot, therefore, be capitalized.

## Question 90

Ram Ltd. purchased machinery for ₹ 80 lakhs, (useful life 4 years and residual value ₹ 8 lakhs). Government grant received is ₹ 32 lakhs.

You are required to show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if the grant is credited to Fixed Assets A/c.

(*MTP April, 2018*) (*5 Marks*)

**Answer:**

**In the books of Ram Ltd.**

**If the grant is credited to Fixed Assets Account:**

1. **Journal Entry (at the time of refund of grant)**

| | | | **In lakhs ₹** | **In lakhs ₹** |
|---|---|---|---|---|
| I | Fixed Assets<br>To Bank A/c<br>(Being grant refunded) | Dr. | 32 | <br>32 |

**2. Value of Fixed Assets after two years but before refund of grant**

| | |
|---|---|
| Fixed assets initially recorded in the books | = ₹ 80 lakhs - ₹ 32 lakhs |
| | = ₹ 48 lakhs |
| Depreciation for each year | = (₹ 48 lakhs - ₹8 lakhs)/4 years |
| | = ₹ 10 lakhs per year for first two years. |
| Value of the assets before refund of grant | = ₹ 48 lakhs - ₹ 20 lakhs |
| | = ₹ 28 lakhs |

**3. Value of Fixed Assets after refund of grant**

| | |
|---|---|
| Value of Fixed Assets before refund of grant | ₹ 28 lakhs |
| Add Refund of grant | ₹ 32 lakhs |
| | ₹ 60 lakhs |

**4. Amount of depreciation for remaining two years**

Value of the fixed assets after refund of grant -residual value of the assets/No. of years

= ₹ 60 lakhs - ₹ 8 lakhs/2

= ₹ 26 lakhs per annum will be charged for next two years.

## Question 91

Shrishti Ltd. contracted with a supplier to purchase machinery which is to be installed in its Department A in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 1,41,870. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month. The technician's services were given by Department B to Department A, which billed the services at ₹ 49,500 per month after adding 10% profit margin.

The machine was purchased at ₹ 1,58,34,000 inclusive of IGST @ 12% for which input credit is available to Shrishti Ltd. ₹55,770 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹ 30,000 to supervise machinery installation at the factory site.

Ascertain the amount at which the Machinery should be capitalized under AS 10 considering that IGST credit is availed by the Shristhi Limited. Internally booked profits should be eliminated in arriving at the cost of machine.

(*RTP November 2019*)

**Answer**

**Calculation of Cost of Fixed Asset (i.e. Machinery)**

| ***Particulars*** | | | ***₹*** |
|---|---|---|---|
| Purchase Price | | Given (₹ 158,34,000 x 100/112) | 1,41,37,500 |
| *Add:* | Site Preparation Cost | Given | 1,41,870 |
| | Technician's Salary | Specific/Attributable overheads for 3 months (See Note) (45,000 x3) | 1,35,000 |
| | Initial Delivery Cost | Transportation | 55,770 |
| | Professional Fees for Installation | Architect's Fees | 30,000 |
| Total Cost of Asset | | | 1,45,00,140 |

## Question 92

(a) Entity A has a policy of not providing for depreciation on PPE capitalized in the year until the following year, but provides for a full year's depreciation in the year of disposal of an asset. Is this acceptable?

(b) Entity A purchased an asset on 1st January 2016 for ₹ 1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil. On 1st January 2020, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years. Calculate the amount of depreciation for each year, if company charges depreciation on Straight Line basis.

(c) The following items are given to you:

**ITEMS**

(1) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment);

(2) Costs of conducting business in a new location or with a new class of customer (including costs of staff training);

(3) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management

(4) Costs of opening a new facility or business, such as, inauguration costs;

(5) Purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

With reference to AS 10 "Property, Plant and Equipment", classify the above items under the following heads:

**HEADS**

(i) Purchase Price of PPE

(ii) Directly attributable cost of PPE or

(iii) Cost not included in determining the carrying amount of an item of PPE.

[*RTP May 2020*]

**Answer**

(a) The depreciable amount of a tangible fixed asset should be allocated on a systematic basis over its useful life. The depreciation method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. Useful life means the period over which the asset is expected to be available for use by the entity. Depreciation should commence as soon as the asset is acquired and is available for use. Thus, the policy of Entity A is not acceptable.

(b) The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e (1,00,000/10 years). On 1st January 2020, the asset's net book value is [1,00,000 – (10,000 x 4)] = ₹ 60,000.

The remaining useful life is 4 years. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of four years. Consequently, it should charge depreciation for the next 4 years at ₹ 15,000 per annum i.e. (60,000/4 years). Depreciation is recognized even if the Fair value of the Asset exceeds its Carrying Amount. Repair and maintenance of an asset do not negate the need to depreciate it.

(c) (1) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment) will be classified as "Directly attributable cost of PPE".

(2) Costs of conducting business in a new location or with a new class of customer (including costs of staff training) will be classified under head (iii)as it will not be included in determining the carrying amount of an item of PPE.

(3) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management will be included in determination of Purchase Price of PPE

(4) Costs of opening a new facility or business, such as, inauguration costs will be classified under head (iii) as it will not be included in determining the carrying amount of an item of PPE.

(5) Purchase price, including import duties and non–refundable purchase taxes, after deducting trade discounts and rebates will be included in determination of Purchase Price of PPE.

## Question 93

Omega Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month.

The machine was purchased at ₹ 1,58,00,000 and ₹ 50,000 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹ 30,000 to supervise machinery installation at the factory site.

You are required to ascertain the amount at which the Machinery should be capitalized under AS 10.

[*RTP, November 2020*]

**Answer**

**Calculation of Cost of Fixed Asset (i.e. Machinery)**

| **Particulars** | | | **₹** |
|---|---|---|---|
| Purchase Price | | Given | 1,58,00,000 |
| Add: | Site Preparation Cost | Given | 1,40,000 |
| | Technician's Salary | Specific/Attributable overheads for 3 months (45,000 x3) | 1,35,000 |
| | Initial Delivery Cost | Transportation | 50,000 |
| | Professional Fees for Installation | Architect's Fees | 30,000 |
| Total Cost of Asset | | | 1,61,55,000 |

## Question 94

Mohan Ltd. has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site.

The details of the incremental costs which will be incurred are: Setup costs of ₹ 5,00,000 to install machinery in the new location; Rent of ₹ 15,00,000; Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.

Mohan Ltd. wants to seek your guidance as whether these costs can be capitalized into the cost of the new building. You are required to advise in line with AS 10 "Property, Plant and Equipment".

*(MTP, May 2020)/(MTP April, 2022) (5 Marks)*

**Answer**

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The costs to be incurred by the company are in the nature of costs of reducing or reorganizing the operations of the company. These costs do not meet that requirement of AS 10 "Property, Plant and Equipment" and cannot, therefore, be capitalized.

## Question 95

Mohan Ltd. has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site.

The details of the incremental costs which will be incurred are: Setup costs of ₹ 5,00,000 to install machinery in the new location; Rent of ₹ 15,00,000; Removal costs of ₹ 3,00,000 to transport the machinery from the old location to the temporary location.

Mohan Ltd. wants to seek your guidance as whether these costs can be capitalized into the cost of the new building. You are required to advise in line with AS 10 "Property, Plant and Equipment".

(*5 Marks*)

**Answer**

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The costs to be incurred by the company are in the nature of costs of reducing or reorganizing the operations of the accompany. These costs do not meet that requirement of AS 10 "Property, Plant and Equipment" and cannot, therefore, be capitalized.

## Question 96

(i) A Limited has contracted with a supplier to purchase machinery which is to be installed at its new plant in four months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹2,10,000. These activities were supervised by an Architect during the entire period, who is employed for this purpose at a salary of ₹35,000 per month. The machinery was purchased for ₹1,27,50,000 and a sum of ₹2,12,500 was incurred towards transportation charges to bring the machinery to the plant site. An Engineer was appointed at a fees of ₹37,500 to supervise the installation of the machinery at the plant site. You are required to ascertain the amount at which the machinery should be capitalized in the books of A Limited.

(ii) B Limited, which operates a major chain of retail stores, has acquired a new store locations. The new location requires substantial renovation expenditure. Management expects that the renovation will last for 4 months during which the store will be closed. Management has prepared the budget for this period including expenditure related to construction and re-modelling costs, salary of staff who shall be preparing the store before its opening and related utilities cost. How would such expenditure be treated in the books of B Limited? (*5 Marks*)

## Question 97

You are required to give the correct accounting treatment for the following in line with provisions of AS 10:

(a) Trozen Ltd. operates a major chain of supermarkets all over India. It acquires a new store in Pune which requires significant renovation expenditure. It is expected that the renovations will be done in 2 months during which the store will be closed. The budget for this period, including expenditure related to construction and remodelling costs (₹ 18 lakhs), salaries of staff (₹ 2 lakhs) who will be preparing the store before its opening and related utilities costs (₹ 1.5 lakhs), is prepared. The cost of salaries of the staff and utilities are operating expenditures that would be incurred even after the opening of the supermarket. What will the treatment of all these expenditures in the books of accounts?

(b) ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs the expenditure on the construction/ development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Can ABC Ltd. capitalize expenditure incurred on these items as property, plant and equipment (PPE)?

**Answer**

**(a)** Trozen Ltd. should capitalize the costs of construction and remodelling the supermarket, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended. The supermarket cannot be opened without incurring the remodelling expenditure. Therefore, this construction and remodelling expenditure of ₹ 18 lakh should be considered as part of the cost of the asset. However, the cost of salaries of the staff ₹ 2 lakh and utilities cost ₹ 1.5 lakh are operating expenditures that would be incurred even after the opening of the supermarket. Therefore, these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by the management and should be expensed.

**(b)** AS 10 states that the cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:

(a) it is probable that future economic benefits associated with the item will flow to the entity; and

(b) the cost of the item can be measured reliably.

Further, the standard provides that the standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. The cost of an item of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalization of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In view of this, even though ABC Ltd. may not be able to recognize expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalized as a part of overall cost of the project. From this, it can be concluded that, in the given case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalized as part of the items of property, plant and equipment of the refinery.

## Question 98

A Ltd. had following assets. Calculate depreciation for the year ended 31st March, 2020 for each asset as per AS 10 (Revised):

(i) Machinery purchased for ₹ 10 lakhs on 1st April, 2015 and residual value after useful life of 5 years, based on 2015 prices is ₹ 10 lakhs.

(ii) Land for ₹ 50 lakhs.

(iii) A Machinery is constructed for ₹ 5,00,000 for its own use (useful life is 10 years). Construction is completed on 1st April, 2019, but the company does not begin using the machine until 31st March, 2020.

(iv) Machinery purchased on 1st April.2017 for ₹ 50,000 with useful life of 5 years and residual value is NIL. On 1st April, 2019, management decided to use this asset for further 2 years only.

(*5 Marks*) (*November 2020*)

**Answer**

**Computation of amount of depreciation as per AS 10**

| | | ₹ |
|---|---|---|
| (i) | Machinery purchased on 1/4/15 for ₹ 10 lakhs (having residual value of ₹ 10 lakhs)<br>Reason: The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost. Therefore, there is no depreciable amount and depreciation is correctly zero. | Nil |
| (ii) | Land (50 lakhs) (considered freehold)<br>Reason: Land has an unlimited useful life and therefore, it is not depreciated. | Nil |
| (iii) | Machinery constructed for own use (₹ 5,00,000/10)<br>Reason: The entity should begin charging depreciation from the date the machine is ready for use i.e. 1st April, 2019. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation. | 50,000 |
| (iv) | Machinery having revised useful life<br>Reason: The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e. (50,000/5 years). On 1st April, 2019 the asset's net book value is [50,000 – (10,000 x 2)] i.e. ₹ 30,000. The remaining useful life is 2 years as per revised estimate. The company should amend the annual provision for depreciation to charge the unamortized cost over the revised remaining life of 2 years. Consequently, it should charge depreciation for the next 2 years at ₹ 15,000 per annum i.e. (30,000 / 2 years). | 15,000 |

## Question 99

Explain 'Bearer Plant' and 'Biological Asset' as per Accounting Standard 10.

(*Study Material*)

**Answer**

As per AS 10 Property, Plant and Equipment, biological asset is a living animal or plant. Bearer plant is a plant that (a) is used in the production or supply of agricultural produce; (b)is expected to bear produce for more than a period of twelve months; and (c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales. Plants cultivated to be harvested as agricultural produce (for example, trees grown for use as lumber); plants cultivated to produce agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales (for example, trees that are cultivated both for their fruit and their lumber); and annual crops (for example, maize and wheat) are not bearer plants.

## Question 100

With reference to AS-10 Revised, classify the items under the following heads:

**HEADS**

**(i)** Purchase Price of Property, plant and Equipment (PPE)
**(ii)** Directly attributable cost of PPE or
**(iii)** Cost not included in determining the carrying amount of an item of PPE.

**ITEMS**

**(1)** Import duties and non-refundable purchase taxes.
**(2)** Initial delivery and handling costs.
**(3)** Initial operating losses, such as those incurred while demand for the output of an item builds up.
**(4)** Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.
**(5)** Trade discounts and rebates.
**(6)** Costs of relocating or reorganizing part or all of the operations of an enterprise.
**(7)** Installation and assembly costs.
**(8)** Administration and other general overhead costs.

(*Study Material*)

**Answer**

**Heads**

(i) Purchase price of PPE
(ii) Directly attributable cost of PPE
(iii) Cost not included in determining the carrying amount of an item of PPE

| | Items | Classified under Head |
|---|---|---|
| 1 | Import duties and non-refundable purchase taxes | (i) |
| 2 | Initial delivery and handling costs | (ii) |
| 3 | Initial operating losses, such as those incurred while demand for the output of an item builds up | (iii) |
| 4 | Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity. | (iii) |
| 5 | Trade discounts and rebates (deducted for computing purchase price) | (i) |
| 6 | Costs of relocating or reorganizing part or all of the operations of an enterprise. | (iii) |
| 7 | Installation and assembly costs | (ii) |
| 8 | Administration and other general overhead costs | (iii) |

## Similar Question

## Question 100A

A Ltd. has incurred the following costs. Determine if the following costs can be added to the invoiced purchase price and included in the initial recognition of the cost of the item of property, plant and equipment:

1. Import duties paid
2. Shipping costs and cost of road transport for taking the machinery to factory
3. Insurance for the shipping
4. Inauguration costs for the factory
5. Professional fees charged by consulting engineer for the installation process
6. Costs of advertising and promotional activities
7. Administration and other general overhead costs
8. Cost of site preparation.

*(RTP May, 2022)*

**Answer**

Included in Cost**:**
Point no. 1, 2, 3, 5, 8 Excluded from Cost:
Point no. 4, 6, 7

## Question 101

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

| | | |
|---|---|---|
| 1. | Cost of the plant (cost per supplier's invoice plus taxes) | ₹ 25,00,000 |
| 2. | Initial delivery and handling costs | ₹ 2,00,000 |
| 3. | Cost of site preparation | ₹ 6,00,000 |
| 4. | Consultants used for advice on the acquisition of the plant | ₹ 7,00,000 |
| 5. | Interest charges paid to supplier of plant for deferred credit | ₹ 2,00,000 |
| 6. | Estimated dismantling costs to be incurred after 7 years | ₹ 3,00,000 |
| 7. | Operating losses before commercial production | ₹ 4,00,000 |

Please advise ABC Ltd. on the costs that can be capitalised in accordance with AS 10 (Revised).

(*Study Material*)

**Answer**

According to AS 10 (Revised), these costs can be capitalised:

| | | |
|---|---|---|
| 1. | Cost of the plant | ₹ 25,00,000 |
| 2. | Initial delivery and handling costs | ₹ 2,00,000 |
| 3. | Cost of site preparation | ₹ 6,00,000 |
| 4. | Consultants' fees | ₹ 7,00,000 |
| 5. | Estimated dismantling costs to be incurred after 7 years | ₹ 3,00,000 |
| | | ₹ 43,00,000 |

**Note:** Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 2,00,000 and operating losses before commercial production amounting to ₹ 4,00,000 are not regarded as directly attributable costs and thus cannot be capitalised. They should be written off to the Statement of Profit and Loss in the period they are incurred.

## Question 102

A Ltd. has entered into a binding agreement with Gamma Ltd. to buy a custom-made machine ₹ 1,00,000. At the end of 20X1-X2, before delivery of the machine, A Ltd. had to change its method of production. The new method will not require the machine ordered and it will be scrapped after delivery. The expected scrap value is nil.

You are required to advise the accounting treatment and give necessary journal entry in the year 20X1-X2.

[*RTP May 2020*]

**Answer**

A liability is recognised when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, A Ltd. should recognise a liability of ₹ 1,00,000 to Gamma Ltd..

When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognised as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognised as an expense.

**Journal entry**

| | | | |
|---|---|---|---|
| Loss on change in production method | Dr. | 1,00,000 | |
| To Gamma Ltd. | | | 1,00,000 |
| (Loss due to change in production method) | | | |
| Profit and loss A/c | Dr. | 1,00,000 | |
| To Loss on change in production method | | | 1,00,000 |
| (Loss transferred to profit and loss account) | | | |

## Question 103

(i) In the year 2018-19, an entity has acquired a new freehold building with a useful life of 50 years for ₹75,00,000. The entity desires to calculate the depreciation charge per annum using a straight-line method. It has identified the following components (with no residual value of lifts & fixtures at the end of their useful life) as follows:

| Component | Useful life (Years) | Cost |
|---|---|---|
| Land | Infinite | ₹10,00,000 |
| Roof | 25 | ₹15,00,000 |
| Lifts | 20 | ₹7,50,000 |
| Fixtures | 10 | ₹2,50,000 |
| Remainder of building | 50 | ₹40,00,000 |
| | | ₹75,00,000 |

Calculate depreciation for the year 2018-19 as per componentization method. Also state the treatment, in case Roof requires replacement at the end of its useful life.

(ii) Entity A, a supermarket chain, is renovating one of its major stores. The store will have more available space for store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodeling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers.

Decide whether the remodeling cost will be capitalized or not as per provision of AS 10 "Property plant & Equipment".

*[MTP October, 2019, 5 marks]*

**Answer**

**(i) Statement showing amount of depreciation as per Componentization Method**

| **Component** | **Depreciation (Per annum) (₹)** |
|---|---|
| Land | Nil |
| Roof | 60,000 |
| Lifts | 37,500 |
| Fixtures | 25,000 |
| Remainder of Building | 80,000 |
| | 2,02,500 |

**Note**: When the roof requires replacement at the end of its useful life the carrying amount will be nil. The cost of replacing the roof should be recognised as a new component.

(ii) The expenditure in remodelling the store will create future economic benefits (in the form of 15% of increase in sales). Moreover, the cost of remodelling can be measured reliably, therefore, it should be capitalized in line with AS 10 PPE.

## Question 104

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom-made machine amounting to ₹4,00,000. As on 31st March, 2018 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'.

Show the treatment of machine in the books of ABC Ltd.

[*MTP October, 2019, 5 marks*] (*MTP March, 2022, 5 marks*)

**Answer**

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹ 4,00,000 payable to XYZ Ltd. When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense. Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2018.

## Question 105

(i) Entity A carried plant and machinery in its books at ₹ 2,00,000 which were destroyed in a fire. These machines were insured 'New for old' and were replaced by the insurance company with new machines of fair value ₹ 20,00,000. The old destroyed machines were acquired by the insurance company and the company did not receive any cash compensation. State, how Entity A should account for the same?

*(MTP, October, 2020) (MTP March, 2022)* (*5 Marks*)

(ii) Omega Ltd, a supermarket chain, is renovating one of its major stores. The store will have more available space for store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers.

Decide whether Omega Ltd. can capitalize the remodelling cost or not as per provisions of AS 10 “Property plant & Equipment”.

*(MTP, October, 2020) (MTP March, 2022)* (*5 Marks*)

**Answer**

**(i)** Entity A should account for a loss in the Statement of Profit and Loss on de-recognition of the carrying value of plant and machinery in accordance with AS 10 on Property, Plant and Equipment. Entity A should separately recognize a receivable and a gain in the income statement resulting from the insurance proceeds once receipt is virtually certain. The receivable should be measured at the fair value of assets provided by the insurer.

**(ii)** The expenditure in remodelling the store will create future economic benefits (in the form of 15% of increase in sales). Moreover, the cost of remodelling can be measured reliably, therefore, it should be capitalized in line with AS 10.

## Question 106

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom-made machine amounting to ₹ 4,00,000. As on 31st March, 2020 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'. Show the treatment of machine in the books of ABC Ltd.

*(MTP, October, 2020)* (*5 marks*)

**Answer**

A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹ 4,00,000 payable to XYZ Ltd. When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense. Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2020.

## Question 107

Neon Enterprise operates a major chain of restaurants located in different cities. The company has acquired a new restaurant located at Chandigarh. The new-restaurant requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the restaurant will be closed.

Management has prepared the following budget for this period –

| | |
|---|---|
| Salaries of the staff engaged in preparation of restaurant before its opening | ₹ 7,50,000 |
| Construction and remodelling cost of restaurant | ₹ 30,00,000 |

Explain the treatment of these expenditures as per the provisions of AS 10 "Property, Plant and Equipment".

**Answer**

As per provisions of AS 10, any cost directly attributable to bring the assets to the location and conditions necessary for it to be capable of operating in the manner indicated by the management are called directly attributable costs and would be included in the costs of an item of PPE.

Management of Neon Enterprise should capitalize the costs of construction and remodelling the restaurant, because they are necessary to bring the restaurant to the condition necessary for it to be capable of operating in the manner intended by management. The restaurant cannot be opened without incurring the construction and remodelling expenditure amounting ₹ 30,00,000 and thus the expenditure should be considered part of the asset.

However, the cost of salaries of staff engaged in preparation of restaurant ₹ 7,50,000 before its opening are in the nature of operating expenditure that would be incurred if the restaurant was open and these costs are not necessary to bring the restaurant to the conditions necessary for it to be capable of operating in the manner intended by management. Hence, ₹ 7,50,000 should be expensed.

## Question 108

Arush Ltd. is installing a new plant in its factory. It provides you the following information:

| | |
|---|---:|
| Cost of the plant (cost as per supplier's invoice) | ₹ 31,25,000 |
| Estimated dismantling costs to be incurred after 5 years | ₹ 2,50,000 |
| Initial delivery and handling costs | ₹ 1,85,000 |
| Cost of site preparation | ₹ 4,50,000 |
| Consultants used for advice on the acquisition of the plant | ₹ 6,50,000 |

You are required to advise Arush Ltd. on the costs that can be capitalised for plant in accordance with AS 10 'Property, Plant and Equipment'. (*MTP, November, 2021*) (*5 Marks*)

**Answer**

According to AS 10 'Property, Plant and Equipment', following costs will be capitalized by Arush Ltd.:

| | ₹ |
|---|---:|
| Cost of the plant | 31,25,000 |
| Initial delivery and handling costs | 1,85,000 |
| Cost of site preparation | 4,50,000 |
| Consultants' fee | 6,50,000 |
| Estimated dismantling costs to be incurred after 5 years | 2,50,000 |
| Total cost of Plant | 46,60,000 |

## Question 109

A property costing ₹ 10,00,000 is bought on 1.4.2020. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 25 years.

The estimated residual value in 25 years' time, based on current year prices, is: Case (a) ₹ 10,00,000 Case (b) ₹ 9,00,000

You are required to compute the amount of depreciation charged for the year ended 31.3.2021.

(*RTP, November 2021*)

**Answer**

**Case (a)**

The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost. There is, therefore, no depreciable amount and depreciation is zero.

**Case (b)**

The company considers that the residual value, based on prices prevailing at the balance sheet date, will be ₹9,00,000 and the depreciable amount is, therefore, ₹1,00,000.

**Annual depreciation (on a straight line basis) will be ₹ 4,000 [{10,00,000 – 9,00,000} ÷ 25].**

## Question 109A

XYZ Limited provided you the following information for the year ended 31st March. 2022:-

(i) The carrying amount of a property at the end of the year amounted to ₹ 2,16,000 (cost/value ₹ 2,50,000 and accumulated depreciation ₹ 34,000). On this date the property was revalued and was deemed to have a fair value of ₹ 1,90,000. The balance on the revaluation surplus relating to a previous revaluation gain for this property was ₹ 20,000.

You are required to calculate the revaluation loss as per AS-10 (Revised) and give its treatment in the books of accounts.

(ii) An asset that originally cost ₹ 76,000 and had accumulated depreciation of ₹ 62,000 was disposed of during the year for ₹ 4,000 cash.

You are required to explain how the disposal should be accounted for in the financial statements as per AS-10 (Revised).

(*Question Paper, May 2022*) (*5 Marks*)

# AS 11: The Effects of Changes in Foreign Exchange Rates

## Question 110

*Classify the following items as monetary or non-monetary item:*

*Inventories*
*Trade Receivables*
*Investment in Equity shares*
*Property, Plant and Equipment.*

(*Study Material*)

**Answer**

| | |
|---|---|
| Inventories | Non-monetary |
| Trade receivables | Monetary |
| Investment in equity shares | Non-monetary |
| Property, Plant and Equipment | Non-monetary |

## Question 111

| | *Exchange Rate per $* |
|---|---|
| *Goods purchased on 1.1.20X1 for US $ 15,000* | *₹ 75* |
| *Exchange rate on 31.3.20X1* | *₹ 74* |
| *Date of actual payment 7.7.20X1* | *₹ 73* |

*You are required to ascertain the loss/gain to be recognized for financial years ended 31st March, 20X1 and 31st March, 20X2 as per AS 11.*

(*Study Material*)

**Answer**

As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.20X1 and corresponding creditors would be recorded at ₹ 11,25,000 (i.e. $15,000 × ₹ 75)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditors of US $15,000 on 31.3.20X1 will be reported at ₹ 11,10,000 (i.e. $15,000 × ₹ 74) and exchange profit of ₹ 15,000 (i.e. 11,25,000 – 11,10,000) should be credited to Profit and Loss account in the year ended 31st March, 20X1.

On 7.7.20X1, creditors of $15,000 is paid at the rate of ₹ 73. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 15,000 (i.e. 11,10,000 – 10,95,000) will be credited to Profit and Loss account in the year ended 31st March, 20X2.

## Question 112

*Kalim Ltd. borrowed US$ 4,50,000 on 01/01/20X1, which will be repaid as on 31/07/20X1. Kalim Ltd. prepares financial statement ending on 31/03/20X1. Rate of exchange between reporting currency (INR) and foreign currency (USD) on differentdates are as under:*

*01/01/20X11 US$ = ₹ 48.00*

*31/03/20X11 US$ = ₹ 49.00*

*31/07/20X11 US$ = ₹ 49.50*

(*Journalise*)

(*Study Material*)

**Answer**

**Journal Entries in the Books of Kalim Ltd.**

| ***Date*** | ***Particulars*** | | ***₹ (Dr.)*** | ***₹ (Cr.)*** |
|---|---|---|---|---|
| 20X1 Jan. 01 | Bank Account (4,50,000 x 48) | Dr. | 216,00,000 | |
| | To Foreign Loan Account | | | 216,00,000 |
| March 31 | Foreign Exchange Difference Account | Dr. | 4,50,000 | |
| | To Foreign Loan Account [4,50,000 x (49-48)] | | | 4,50,000 |
| July 01 | Foreign Exchange Difference Account | Dr. | 2,25,000 | |
| | [4,50,000 x (49.5-49)] | | | |
| | Foreign Loan Account | Dr. | 220,50,000 | |
| | To Bank Account | | | 2,22,75,000 |

# Similar Question

## Question 112A

Kumar Ltd. borrowed US $ 3,00,000 on 31-12-2020 which will repaid as on 30-06-2021. Kumar Ltd. prepares its financial statements ending on 31-03-2021. Rate of exchange between reporting currency (Rupee) and foreign currency (US$) on different dates are as under:

| | |
|---|---|
| 31-12-2020 | 1 US $ = ₹ 44.00 |
| 31-03-2021 | 1 US $ = ₹ 44.50 |
| 30-06-2021 | 1 US $ = ₹ 44.75 |

(i) Calculate Borrowings in reporting currency to be recognized in the books on above mentioned dates and also show journal entries for the same.

(ii) if borrowings were repaid on 28-2-2021 on which date exchange rate was 1 US $ = ₹ 44.20 then what entry should be passed?

*(RTP May, 2022)*

**Answer**

**(i)** As per AS 11 'The Effect of Changes in Foreign Exchange Rates", a foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction. Moreover, at each balance sheet date, foreign currency monetary items should be reported using the closing rate. Accordingly, on 31.12.2020 borrowings will be recorded at ₹ 1,32,00,000 (i.e., ₹ 3,00,000 × ₹44.00). On 31.3.2021 borrowings (monetary items) will be recorded at ₹ 1,33,50,000 (i.e. $ 3,00,000 ×

₹44.50).

**Journal of Kumar Ltd.**

| Date | Particular | | Dr. (₹) | Cr. (₹) |
|---|---|---|---|---|
| 31-12-2020 | Bank A/c | Dr. | 1,32,00,000 | |
| | To Foreign Loan Account | | | 1,32,00,000 |
| 31-03-2021 | Foreign Exchange Difference Account A/c | Dr. | 1,50,000 | |
| | To Foreign Loan Account | | | 1,50,000 |
| 30-06-2021 | Foreign Loan Account A/c | Dr. | 1,33,50,000 | |
| | Foreign Exchange Difference Account A/c | Dr. | 75,000 | |
| | To Bank A/c | | | 1,34,25,0000 |

**(ii)** In case borrowings were repaid before Balance Sheet Date, then the entry would be as follows:

| Date | Particular | | Dr. (₹) | Cr. (₹) |
|---|---|---|---|---|
| 28-02-2021 | Foreign Loan Account A/c | Dr. | 1,32,00,000 | |
| | Foreign Exchange Difference Account A/c | Dr. | 60,000 | |
| | To Bank A/c | | | 1,32,60,000 |

**Working Notes:**

(i) The exchange difference of ₹ 1,50,000 is arising because the transaction has been reported at different rate (₹ 44.50 = 1 US $) from the rate initially recorded (i.e., ₹ 44 = 1 US $) from the rate initially recorded (i.e., ₹ 44 = 1 US $)

(ii) The exchange difference of ₹ 75,000 is arising because the transaction has been settled at an exchange rate (₹ 44.75 = 1 US$) different from the rate at which reported in the last financial statements (₹ 44.50 = 1 US$).

(iii) The exchange difference of ₹ 60,000 is arising because the transaction has been settled at a different rate (i.e., ₹ 44.20 = 1 US $) than the rate at which initially recorded (1 US $ = ₹ 44.00)

## Question 113

*Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 20X1, payable after three months. Company entered into a forward contract for three months @₹ 49.15 per dollar. Exchange rate per dollar on 01st Feb. was ₹ 48.85. How will you recognise the profit or loss on forward contract in the books of Rau Ltd.?*

(*Study Material*)

**Answer**

| | |
|---|---|
| Forward Rate | ₹ 49.15 |
| *Less*: Spot Rate | (₹ 48.85) |
| Premium on Contract | ₹ 0.30 |
| Contract Amount | US$ 1,00,000 |
| Total Loss (1,00,000 x 0.30) | ₹ 30,000 |

Contract period 3 months (2 months falling in the year ended 31st March, 20X1)

Loss to be recognised (30,000/3) x 2 = ₹ 20,000 in the year ended 31st March, 20X1. Rest ₹ 10,000 will be recognised in the following year.

## Question 114

*Mr. A bought a forward contract for three months of US$ 1,00,000 on 1st December at 1 US$ = ₹ 47.10 when exchange rate was US$ 1 = ₹ 47.02. On 31st December when he closed his books exchange rate was US$ 1 = ₹ 47.15. On 31st January, he decided to sell the contract at ₹ 47.18 per dollar. Show how the profits from contract will be recognised in the books.*

(*Study Material*)

**Answer**

Since the forward contract was for speculation purpose the premium on contract i.e. the difference between the spot rate and contract rate will not be recorded in the books. Only when the contract is sold the difference between the contract rate and sale rate will be recorded in the Profit & Loss Account.

| | |
|---|---|
| Sale Rate | ₹ 47.18 |
| Less: Contract Rate | (₹ 47.10) |
| Premium on Contract | ₹ 0.08 |
| Contract Amount | US$ 1,00,000 |
| Total Profit (1,00,000 x 0.08) | ₹ 8,000 |

## Question 115

*Assets and liabilities and income and expenditure items in respect of foreign branches (integral foreign operations) are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to the statement of profit and loss. Comment.*

(*Study Material*)

**Answer**

The financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures described in AS 11. The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself.

Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. For practical reasons, a rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realisable value is translated applying exchange rate when realisable value is determined which is generally closing rate.

Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account. Exchange difference arising on the translation of the financial statement of foreign operation may have tax effect which should be dealt as per AS 22 'Accounting for Taxes on Income'.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11.

## Question 116

*A business having the Head Office in Kolkata has a branch in UK. The following is the trial balance of Branch as at 31.03.20X4:*

| ***Account Name*** | | ***Amount in £*** |
|---|---|---|
| | ***Dr.*** | ***Cr.*** |
| *Property, Plant and Equipment (Purchased on 01.04.20X1)* | *5,000* | |
| *Debtors* | *1,600* | |
| *Opening Stock* | *400* | |
| *Goods received from Head Office Account* | *6,100* | |
| *(Recorded in HO books as ₹ 4,02,000)* | | |
| *Sales* | | *20,000* |
| *Purchases* | *10,000* | |
| *Wages* | *1,000* | |
| *Salaries* | *1,200* | |
| *Cash* | *3,200* | |
| *Remittances to Head Office (Recorded in HO books as ₹ 1,91,000)* | *2,900* | |
| *Head Office Account (Recorded in HO books as ₹ 4,90,000)* | | *7,400* |
| *Creditors* | | *4,000* |

- *Closing stock at branch is £ 700 on 31.03.20X4.*
- *Depreciation @ 10% p.a. is to be charged on Property, plant and equipment.*
- *Prepare the trial balance after been converted in Indian Rupees.*
- *Exchange rates of Pounds on different dates are as follow: 01.04.20X1– ₹ 61; 01.04.20X3– ₹ 63 & 31.03.20X4 – ₹ 67*

(*Study Material*)

**Answer**

**Trial Balance of the Foreign Branch converted into Indian Rupees as on March 31, 20X4**

| ***Particulars*** | ***£ (Dr.)*** | ***£ (Cr.)*** | ***Conversion Basis*** | ***₹ (Dr.)*** | ***₹ (Cr.)*** |
|---|---|---|---|---|---|
| Property, plant and equipment | 5,000 | | Transaction Date Rate | 3,05,000 | |
| Debtors | 1,600 | | Closing Rate | 1,07,200 | |
| Opening Stock | 400 | | Opening Rate | 25,200 | |
| Goods Received from HO | 6,100 | | Actuals | 4,02,000 | |
| Sales | | 20,000 | Average Rate | | 13,00,000 |
| Purchases | 10,000 | | Average Rate | 6,50,000 | |
| Wages | 1,000 | | Average Rate | 65,000 | |
| Salaries | 1,200 | | Average Rate | 78,000 | |
| Cash | 3,200 | | Closing Rate | 2,14,400 | |
| Remittance to HO | 2,900 | | Actuals | 1,91,000 | |
| HO Account | | 7,400 | Actuals | | 4,90,000 |
| Creditors | | 4,000 | Closing Rate | | 2,68,000 |
| Exchange Rate Difference | | | Balancing Figure | 20,200 | |
| | 31,400 | 31,400 | | 20,58,000 | 20,58,000 |
| Closing Stock | 700 | | Closing Rate | 46,900 | |
| Depreciation | 500 | | Fixed Asset Rate | 30,500 | |

## Question 117

*A Ltd. purchased fixed assets costing ₹ 3,000 lakhs on 1.1.20X1 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40.00 and ₹ 42.50 as on 1.1.20X1 and 31.12.20X1 respectively. First instalment was paid on 31.12.20X1. The entire difference in foreign exchange has been capitalised.*

*You are required to state, how these transactions would be accounted for.*

(*Study Material*)

**Answer**

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognised as income or expense.

Calculation of Exchange Difference:

$$\text{Foreign currency loan} = \frac{₹3{,}000 \text{ lakhs}}{₹40} = 75 \text{ lakhs US Dollars}$$

Exchange difference = 75 lakhs US Dollars × (42.50 – 40.00) = ₹187.50 lakhs (including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting ₹ 187.50 lakhs should be charged to profit and loss account for the year.

# QUESTION BANK

## Question 118

(i) ABC Ltd. a Indian Company obtained long term loan from WWW private Ltd., a U.S. company amounting to ₹30,00,000. It was recorded at US $1 = ₹60.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2018) was US $1 = ₹62.00.

(ii) Trade receivable includes amount receivable from Preksha Ltd., ₹10,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹59.00. The exchange rate on balance sheet date (31.03.2018) was US $1 = ₹62.00.

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of ABC Ltd. (*November 2018*) (*5 Marks*)

**Answer:**

**Amount of Exchange difference and its Accounting Treatment**

| Long term Loan | | Foreign Currency Rate | ₹ |
|---|---|---|---|
| (i) | Initial recognition US $ 50,000 ₹ (30,00,000/60) | 1 US $ = ₹ 60 | 30,00,000 |
| | Rate on Balance sheet date | 1 US $ = ₹ 62 | |
| | Exchange Difference Loss US $ 50,000 x ₹ (62 – 60) | | 1,00,000 |
| | Treatment: Credit Loan A/c | | |
| | and Debit FCMIT D A/c or Profit and Loss A/c by ₹ 1,00,000 | | |
| | Trade receivables | | |
| (ii) | Initial recognition US $ 16,949.152* (₹10,00,000/59) | | |
| | Rate on Balance sheet date | 1 US $ = ₹ 59 | 10,00,000 |
| | Exchange Difference Gain US $ 16,949.152* x ₹ (62-59) | 1 US $ = ₹ 62 | |
| | Treatment: Credit Profit and Loss A/c by ₹ 50,847.456* | | 50,847.456* |
| | And Debit Trade Receivables | | |

Thus, Exchange Difference on Long term loan amounting ₹ 1,00,000 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on trade receivables amounting ₹ 50,847.456 is required to be transferred to Profit and Loss A/c.

## Question 119

AXE Limited purchased fixed assets costing $ 5,00,000 on 1st January 2018 from an American company M/s M & M Limited. The amount was payable after 6 months. The company entered into a forward contract on 1st January 2018 for five months @ ₹62.50 per dollar. The exchange rate per dollar was as follows:

| | |
|---|---|
| On 1st January, 2018 | ₹60.75 per dollar |
| On 31st March, 2018 | ₹63.00 per dollar |

You are required to state how the profit or loss on forward contract would be recognized in the books of AXE Limited for the year ending 2017-18, as per the provisions of AS 11.

(*November 2018*) (*4 Marks*)

**Answer:**

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", an enterprise may enter into a forward exchange contract to establish the amount of the reporting currency required, the premium or discount arising at the inception of such a forward exchange contract should be amortized as expenses or income over the life of the contract.

| | |
|---|---|
| Forward Rate | ₹ 62.50 |
| *Less*: Spot Rate | (₹ 60.75) |
| Premium on Contract | ₹ 1.75 |
| Contract Amount | US$ 5,00,000 |
| Total Loss (5,00,000 x 1.75) | ₹ 8,75,000 |
| Contract period 5 months | |

3 months falling in the year 2017-18; therefore loss to be recognized in 2017-18 (8,75,000/5) x 3 = ₹ 5,25,000. Rest ₹ 3,50,000 will be recognized in the following year 2018-19.

## Question 120

ABC Ltd. borrowed US $ 5,00,000 on 01/01/2017, which was repaid as on 31/07/2017. ABC Ltd. prepares financial statement ending on 31/03/2017. Rate of Exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

| 01/01/2017 | 1 US$ = | ₹ 68.50 |
|---|---|---|
| 31/03/2017 | 1 US$ = | ₹ 69.50 |
| 31/07/2017 | 1 US$ = | ₹70.00 |

You are required to pass necessary journal entries in the books of ABC Ltd. as per AS 11.

(*May 2018*) (*5 Marks*)

**Answer**

**Journal Entries in the Books of ABC Ltd.**

| Date | Particulars | | ₹ (Dr.) | ₹ (Cr.) |
|---|---|---|---|---|
| Jan. 01,2017 | Bank Account (5,00,000 × 68.50) | Dr. | 342,50,000 | |
| | To Foreign Loan Account | | | 342,50,000 |
| Mar. 31,2017 | Foreign Exchange Difference Account | Dr. | 5,00,000 | |
| | To Foreign Loan Account [5,00,000 × (69.50-68.50)] | | | 5,00,000 |
| Jul. 31,2017 | Foreign Exchange Difference Account [5,00,000 × (70-69.5)] | Dr. | 2,50,000 | |
| | Foreign Loan Account | Dr. | 347,50,000 | |
| | To Bank Account | | | 350,00,000 |

## Question 121

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 2016, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st Feb. was ₹ 48.85. How will you recognise the profit or loss on forward contract in the books of Rau Ltd.?

(*RTP May 2019*)

**Answer:**

| | |
|---|---|
| Forward Rate | ₹ 49.15 |
| *Less*: Spot Rate | (₹ 48.85) |
| Premium on Contract | ₹0.30 |
| Contract Amount | US$ 1,00,000 |
| Total Loss (1,00,000 x 0.30) | ₹ 30,000 |

Contract period 3 months

Two falling the year 2016-17; therefore loss to be recognised (30,000/3) x 2 = ₹ 20,000. Rest ₹ 10,000 will be recognised in the following year.

## Question 122

(i) Classify the following items as monetary or non-monetary item:
Share Capital
Trade Receivables
Investment in Equity shares
Fixed Assets.

(ii)

| | Exchange Rate per $ |
|---|---|
| Goods purchased on 1.1.2017 for US $ 15,000 | ₹75 |
| Exchange rate on 31.3.2017 | ₹74 |
| Date of actual payment 7.7.2017 | ₹73 |

You are required to ascertain the loss/gain for financial years 2016-17 and 2017-18, also give their treatment as per AS 11.

(*RTP November 2018*)

**Answer:**

**(i)**

| | |
|---|---|
| Share capital | Non-monetary |
| Trade receivables | Monetary |
| Investment in equity shares | Non-monetary |
| Fixed assets | Non-monetary |

(ii) As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2017 and corresponding creditor would be recorded at ₹ 11,25,000 (i.e. $15,000 x ₹ 75)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditors of US $15,000 on 31.3.2017 will be reported at ₹ 11,10,000 (i.e. $15,000 × ₹ 74) and exchange profit of ₹ 15,000 (i.e. 11,25,000 - 11,10,000) should be credited to Profit and Loss account in the year 2016-17.

On 7.7.2017, creditors of $15,000 is paid at the rate of ₹ 73. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 15,000 (i.e. 11,10,000 - 10,95,000) will be credited to Profit and Loss account in the year 2017-18.

## Question 123

Power Track Ltd. purchased a plant for US$ 50,000 on 31st October, 2016 payable after 6 months. The company entered into a forward contract for 6 months @ ₹ 64.25 per Dollar. On 31st October, 2016, the exchange rate was ₹ 61.50 per Dollar.

You are required to calculate the amount of the profit or loss on forward contract to be recognized in the books of the company for the year ended 31st March, 2017.

(*RTP May 2018*)

**Answer:**

**Calculation of profit or loss to be recognized in the books of Power Track Limited**

| | ₹ |
|---|---|
| Forward contract rate | 64.25 |
| Less: Spot rate | (61.50) |
| Loss on forward contract | 2.75 |
| Forward Contract Amount | $ 50,000 |
| Total loss on entering into forward contract = ($ 50,000 × ₹ 2.75) | ₹1,37,500 |
| Contract period | 6 months |
| Loss for the period 1st November, 2016 to 31st March, 2017 i.e. 5 months falling in the year 2016-2017 | 5 months |
| Hence, Loss for 5 months will be ₹ 1,37,500 × 5/6 = | ₹ 1,14,583 |

Thus, the loss amounting to ₹ 1,14,583 for the period is to be recognized in the year ended 31st March, 2017.

## Question 124

(i) Trade receivables as on 31.3.2019 in the books of XYZ Ltd. include an amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, i.e. at US $ 1= ₹ 58.50. US $ 1 = ₹ 61.20 on 31.3.2019.

Explain briefly the accounting treatment needed in this case as per AS 11 as on 31.3.2019.

(ii) Power Track Ltd. purchased a plant for US$ 50,000 on 31st October, 2018 payable after 6 months. The company entered into a forward contract for 6 months @₹ 64.25 per Dollar. On 31st October, 2018, the exchange rate was ₹ 61.50 per Dollar.

You are required to recognise the profit or loss on forward contract in the books of the company for the year ended 31st March, 2019.

(*RTP November 2019*)

**Answer**

(i) As per AS 11 “The Effects of Changes in Foreign Exchange Rates”, exchange differences arising on the settlement of monetary items or on reporting an enterprise’s monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

Accordingly, exchange difference on trade receivables amounting ₹ 23,076 {₹5,23,076(US $ 8547* x ₹ 61.20) less ₹ 5,00,000} should be charged to profit & Loss account.

(ii) Calculation of profit or loss to be recognized in the books of Power Track Limited

| | ₹ |
|---|---|
| Forward contract rate | 64.25 |
| *Less:* Spot rate | (61.50) |
| Loss on forward contract | 2.75 |
| Forward Contract Amount | $ 50,000 |
| Total loss on entering into forward contract= ($ 50,000 × ₹ 2.75) | ₹1,37,500 |
| Contract period | 6 months |
| Loss for the period 1st November, 2018 to 31st March, 2019 i.e. 5 months falling in the year 2018-2019 | 5 months |
| Hence, Loss for 5 months will be ₹ $1,37,500 \times \frac{5}{6} =$ | ₹ 1,14,583 |

Thus, the loss amounting to ₹ 1,14,583 for the period is to be recognized in the year ended 31st March, 2019.

## Question 125

(i) AXE Limited purchased fixed assets costing $ 5,00,000 on 1st Jan. 2018 from an American company M/s M&M Limited. The amount was payable after 6 months. The company entered into a forward contract on 1st January 2018 for five months @ ₹ 62.50 per dollar. The exchange rate per dollar was as follows:

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* US $ 8,547 = 5,00,000/58.50

On 1st January, 2018 ₹ 60.75 per dollar

On 31st March, 2018 ₹ 63.00 per dollar

You are required to state how the profit or loss on forward contract would be recognized in the books of AXE Limited for the year ending 2017-18, as per the provisions of AS 11.

(ii) Assets and liabilities and income and expenditure items in respect of integral foreign operations are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to revenue. You are required to comment in line with AS 11.

[*RTP May 2020*]

**Answer**

(i) As per AS 11 "The Effects of Changes in Foreign Exchange Rates", an enterprise may enter into a forward exchange contract to establish the amount of the reporting currency required, the premium or discount arising at the inception of such a forward exchange contract should be amortized as expenses or income over the life of the contract.

| | | |
|---|---|---|
| Forward Rate | | ₹ 62.50 |
| *Less*: Spot Rate | | (₹ 60.75) |
| Premium on Contract | | ₹ 1.75 |
| Contract Amount | US$ 5,00,000 | |
| Total Loss (5,00,000 x 1.75) | | ₹ 8,75,000 |
| Contract period 5 months | | |

3 months falling in the year 2017-18; therefore loss to be recognized in 2017-18 (8,75,000/5) x 3 = ₹5,25,000. Rest ₹ 3,50,000 will be recognized in the following year 2018-19.

(ii) Financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures described in paragraphs 8 to 16 of AS 11 (Revised 2003). The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself. Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate. Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11 (Revised 2003).

## Question 126

Classify the following items as monetary or non-monetary item:

Share Capital

Trade Receivables

Investment in Equity shares

Fixed Assets.

[*RTP, November 2020*]

**Answer**

| | |
|---|---|
| Share capital | Non-monetary |
| Trade receivables | Monetary |
| Investment in equity shares | Non-monetary |
| Fixed assets | Non-monetary |

## Question 127

| | **Exchange Rate per $** |
|---|---|
| Goods purchased on 1.1.2019 for US $ 15,000 | ₹ 75 |
| Exchange rate on 31.3.2019 | ₹ 74 |
| Date of actual payment 7.7.2019 | ₹ 73 |

You are required to ascertain the loss/gain to be recognized for financial years 2018- 19 and 2019-20 as per AS 11.

[*RTP, November 2020*]

**Answer**

As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2019 and corresponding creditors would be recorded at ₹ 11,25,000 (i.e. $15,000 × ₹ 75)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditors of US $15,000 on 31.3.2019 will be reported at ₹ 11,10,000 (i.e. $15,000 × ₹ 74) and exchange profit of ₹ 15,000 (i.e. 11,25,000 – 11,10,000) should be credited to Profit and Loss account in the year 2018-19.

On 7.7.2019, creditors of $15,000 is paid at the rate of ₹ 73. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 15,000 (i.e. 11,10,000 – 10,95,000) will be credited to Profit and Loss account in the year 2019-20.

## Question 128

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.03.2020

(i) Debtors include amount due from Mr. S ₹ 9,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹ 72.00
US $ 1=₹73.50 on 31st March,2020
US $ 1= ₹ 72.50 on 1st April,2019.

(ii) Long term loan taken on 1st April, 2019 from a U.S. company amounting to ₹ 75,00,000. ₹5,00,000 was repaid on 31st December, 2019, recorded at US $ 1 = ₹ 70.50. interest has been paid as and when debited by the US company.
US $1= ₹ 73.50 on 31st March,2020
US $1=1₹ 72.50 on 1st April, 2019. (*5 marks*)

**Answer**

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long - term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

| | ***Foreign Currency Rate*** | ***₹*** |
|---|---|---|
| Debtors | | |
| Initial recognition US $12,500 (9,00,000/72) | 1 US $ = ₹72 | 9,00,000 |
| Rate on Balance sheet date | 1 US $ = ₹ 73.50 | |
| Exchange Difference Gain US $ 12,500 X (73.50- 72) | | 18,750 |
| Treatment: Credit Profit and Loss A/c by ₹ 18,750 | | |
| Long term Loan | | |
| Initial recognition US $ 1,03,448.28 (75,00,000/72.50) | 1 US $ = ₹ 73.50 | 75,00,000 |
| Rate on Balance sheet date | 1 US $ = ₹ 73.50 | |
| Exchange Difference Loss after adjustment of exchange gain on repayment of ₹ 5,00,000 | | |
| ₹ 67,987.48 [82,171.88 (US $ 96,356.08 X ₹ 73.5 less ₹ 70,00,000) less profit 14,184.40 | | |
| [US $ 7,092.2 (5,00,000/70.5) X ₹ 2)] NET LOSS | | 67,987.48* |
| Treatment: Credit Loan A/c and<br>Debit FCMITD A/C or Profit and Loss A/c by ₹ 67,987.48 | | |

Thus, Exchange Difference on Long term loan amounting ₹ 67,987.48 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting ₹ 18,750 is required to be transferred to Profit and Loss A/c.

NOTE 1: *Exchange Difference Loss (net of adjustment of exchange gain on repayment of ₹ 5,00,000) has been calculated in the above solution. Alternative considering otherwise also possible.

NOTE 2: Date of sales transaction of ₹ 9 lakhs has not been given in the question and hence it has been assumed that the transaction took place during the year ended 31 March 2020.

## Question 129

(a) Classify the following items into Monetary and Non-monetary:

(i) Share capital; (ii) Trade Payables; (iii) Cash balance; (iv) Property, plant and equipment

(b) Trade payables of CAT Ltd. include amount payable to JBB Ltd., ₹ 10,00,000 recorded at the prevailing exchange rate on the date of transaction, transaction recorded at US $1 = ₹ 80.00. The exchange rate on balance sheet date (31.03.2020) was US $1 = ₹ 85.00. You are required to calculate the amount of exchange difference and also explain the accounting treatment needed for this as per AS 11 in the books of CAT Ltd.

**Answer**

**(a)** Share capital - Non-monetary; Trade Payables - Monetary
Cash balance – Monetary; Property, plant and equipment - Non-monetary

**(b) Amount of Exchange difference and its Accounting Treatment**

| | Foreign Currency Rate | ₹ |
|---|---|---|
| **Trade payables** | | |
| Initial recognition US $ 12,500 (₹10,00,000/80) | 1 US $ = ₹ 80 | 10,00,000 |
| Rate on Balance sheet date | 1 US $ = ₹ 85 | |
| Exchange Difference loss US $ 12,500 x ₹ (85-80) | | 62,500 |
| Treatment: | | |
| Debit Profit and Loss A/c by ₹ 62,500 and Credit Trade Payables | | |

Thus, Exchange Difference on trade payables amounting ₹ 62,500 is required to be transferred to Profit and Loss.

## Question 130

Shan Builders Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2019-20 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment, exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2020 ₹ 62 per US $. If Shan Builders Limited had borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%. You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2020 as per applicable Accounting Standards.

**Answer**

**(i)** Interest for the period 2019-20
= US $ 10 lakhs x 4% × ₹ 62 per US $ = ₹ 24.80 lakhs

**(ii)** Increase in the liability towards the principal amount
= US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs

**(iii)** Interest that would have resulted if the loan was taken in Indian currency
= US $ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs

**(iv)** Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs. Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

## Question 131

Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognised at each Balance Sheet date?

(*Study Material*)

**Answer**

As per AS 11' The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from or required to disburse, such item at the balance sheet date.

## Question 132

Distinguish Non-Integral Foreign Operation (NFO) with Integral Foreign Operation (IFO) as per AS 11.

**Answer**

As per AS 11, Integral foreign operation (IFO) is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations. In contrast, a non-integral foreign operation (NFO) is a foreign operation that is not an integral operation.

## Question 133

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3. 20X1.

Trade receivables include amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $ 1= ₹58.50.

Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at US $ 1 = ₹ 55.60, taking exchange rate prevailing at the date of transaction. US $ 1 = ₹61.20 was on 31.3.20X1. (*Study Material*)

**Answer**

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortised over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

| ***Trade receivables*** | ***Foreign Currency Rate*** | ***₹*** |
|---|---|---|
| Initial recognition US $8,547 (5,00,000/58.50) | 1 US $ = ₹ 58.50 | 5,00,000 |
| Rate on Balance sheet date | 1 US $ = ₹ 61.20 | |
| Exchange Difference Gain US $ 8,547 X (61.20-58.50) | | 23,077 |
| Treatment: Credit Profit and Loss A/c by ₹ 23,077 | | |
| Long term Loan | | |
| Initial recognition US $ 1,07,913.67 (60,00,000/55.60) | 1 US $ = ₹ 55.60 | 60,00,000 |
| Rate on Balance sheet date | 1 US $ = ₹ 61.20 | |
| Exchange Difference Loss US $ 1,07,913.67 X (61.20 – 55.60) | | 6,04,317 |
| Treatment: Credit Loan A/c<br>And Debit FCMITD A/C or Profit and Loss A/c by ₹ 6,04,317 | | |

Thus Exchange Difference on Long term loan amounting ₹ 6,04,317 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting ₹ 23,077 is required to be transferred to Profit and Loss A/c.

## Question 134

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 2020, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st Feb. was ₹ 48.85. How will you recognize the profit or loss on forward contract in the books of Rau Ltd.?

*(5 Marks) (MTP, May 2020)*

**Answer:**

| | |
|---|---|
| Forward Rate | ₹ 49.15 |
| Less: Spot Rate | (₹ 48.85) |
| Premium on Contract | ₹ 0.30 |
| Contract Amount | US$ 1,00,000 |
| Total Loss (1,00,000 x 0.30) | ₹ 30,000 |

Contract period 3 months

Two months falling in the year ended 31st March, 2020; therefore loss to be recognized (30,000/3) x 2 = ₹ 20,000.

Balance amount of ₹ 10,000 will be recognized in the following financial year.

## Question 135

Om Ltd. purchased an item of property, plant and equipment for US $ 50 lakh on 01.04.2019 and the same was fully financed by the foreign currency loan [US $] repayable in five equal instalments annually. (Exchange rate at the time of purchase was 1 US $ = ₹ 60]. As on 31.03.2020 the first instalment was paid when 1 US $ fetched ₹ 62.00. The entire loss on exchange was included in cost of goods sold. Om Ltd. normally provides depreciation on an item of property, plant and equipment at 20% on WDV basis and exercised the option to adjust the cost of asset for exchange difference arising out of loan restatement and payment. Calculate the amount of exchange loss, its treatment and depreciation on this item of property, plant and equipment.

*(MTP, October, 2020)* (*5 Marks*)

**Answer**

Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring an item of property, plant and equipment should be adjusted in the carrying amount of the respective item of property, plant and equipment as Om Ltd. has exercised the option and it is long term foreign currency monetary item. Thus, the entire exchange loss due to variation of ₹ 20 lakh on 31.03.2020 on payment of US $ 10 lakh, should be added to the carrying amount of an item of property, plant and equipment and not to the cost of goods sold. Further, depreciation on the unamortized depreciable amount should also be provided.

**Calculation of Exchange loss:**

Foreign currency loan (in ₹) = (50 lakh $ x ₹ 60) = ₹ 3,000 lakh

Exchange loss on outstanding loan on 31.03.2020 = ₹ 40 lakh US $ x (62.00-60.00) = ₹ 80 lakh.

So, ₹ 80 lakh should also be added to cost of an item of property, plant and equipment with corresponding credit to outstanding loan in addition to ₹ 20 lakh on account of exchange loss on payment of instalment. The total cost of an item of property, plant and equipment to be increased by ₹ 100 lakh. Total depreciation to be provided for the year 2019 - 2020 = 20% of (₹ 3,000 lakh + 100 lakh) = ₹ 620 lakh.

## Question 136

Om Ltd. purchased an item of property, plant and equipment for US $ 50 lakh on 01.04.20 20 and the same was fully financed by the foreign currency loan [US $] repayable in five equal instalments annually. (Exchange rate at the time of purchase was 1 US $ = ₹ 60]. As on 31.03.2021 the first instalment was paid when 1 US $ fetched ₹ 62.00. The entire loss on exchange was included in cost of goods sold by the accountant. Om Ltd. provides depreciation on an item of property, plant and equipment at 20% on WDV basis and wants to exercise the option to adjust the cost of asset for exchange difference arising out of loan restatement and payment.

You are required to calculate the amount of exchange loss, its treatment and depreciation on this item of property, plant and equipment.

*(MTP, October 2021) (5 Marks)*

**Answer**

Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring an item of property, plant and equipment should be adjusted in the carrying amount of the respective item of property, plant and equipment as Om Ltd. has exercised the option and it is long term foreign currency monetary item. Thus, the entire exchange loss due to variation of ₹ 20 lakh on 31.03.2021 on payment of US $ 10 lakh, should be added to the carrying amount of an item of property, plant and equipment and not to the cost of goods sold. Further, depreciation on the unamortized depreciable amount should also be provided.

Calculation of Exchange loss:

Foreign currency loan (in ₹) = (50 lakh $ x ₹ 60) = ₹ 3,000 lakh

Exchange loss on outstanding loan on 31.03.2021 = ₹ 40 lakh US $ x (62.00-60.00) = ₹ 80 lakh.

So, ₹ 80 lakh should also be added to cost of an item of property, plant and equipment with corresponding credit to outstanding loan in addition to ₹ 20 lakh on account of exchange loss on payment of instalment. The total cost of an item of property, plant and equipment to be increased by ₹ 100 lakh. Total depreciation to be provided for the year 2020 - 2021 = 20% of (₹ 3,000 lakh + 100 lakh) = ₹ 620 lakh.

## Question 137

"Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date? Classify the following as monetary or non- monetary item:

(i) Share Capital

(ii) Trade Receivables

(iii) Investments

(iv) Fixed Assets.

(*MTP, November, 2021*) (*5 Marks*)

**Answer**

As per AS 11' The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from or required to disburse, such item at the balance sheet date.

| | |
|---|---|
| Share capital | Non-monetary |
| Trade receivables | Monetary |
| Investments | Non-monetary |
| Fixed assets | Non-monetary |

## Question 138

Mona Ltd. purchased a plant for US$ 1,00,000 on 01st December 2020, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st December was ₹ 48.85. How will you recognize the profit or loss on forward contract in the books of Mona Ltd for the year ended 31st March, 2021?

(*RTP, November 2021*)

**Answer**

| | |
|---|---:|
| Forward Rate | ₹ 49.15 |
| *Less*: Spot Rate | (₹ 48.85) |
| Premium on Contract | ₹ 0.30 |
| Contract Amount | US$ 1,00,000 |

Total Loss (1,00,000 x 0.30) ₹ 30,000 to be recognized in year ended 31.3.2021.

## Question 139

(i) PP Ltd. an Indian Company acquired long term finance from WW (P) Ltd, a U.S. company, amounting to ₹ 40,88,952. The transaction was recorded at US $1 = ₹ 72.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2021) is US $1 = ₹73,60.

(ii) Trade receivables of PP Ltd. include amount receivable from Preksha Ltd, ₹20,00,150 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹73.40. The exchange rate on balance sheet date (31.03.2021) is US $1 = ₹ 73.60. Exchange rate on 1st April, 2020 is US $1= ₹74.00

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of PP Ltd.

(*Suggested December 2021*) (*5 Marks*)

***Answer***

**(i) Long term Finance**

| | **Foreign Currency Rate** | **₹** |
|---|---|---|
| Initial recognition US $ 56,791 (40,88,952/72) | 1 US $ = ₹ 72 | 40,88,952 |
| Rate on Balance sheet date | 1 US $ = ₹ 73.60 | |
| Exchange Difference Loss [US $ 56,791 x (73.60 – 72)] | | 90,866 (rounded off) |

As per AS 11 “The Effects of Changes in Foreign Exchange Rates”, exchange differences arising on the settlement of monetary items or on reporting an enterprise’s monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a “Foreign Currency Monetary Item Translation Difference Account” in the enterprise’s financial statements and amortized over t he balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

Treatment needed in this case: PP Ltd. can either Debit Foreign Currency Monetary Item Translation Difference (FCMITD) A/c or Debit Profit and Loss A/c by ₹ 90,866 and Credit Loan A/c

**(ii) Trade Receivables**

| | Foreign Currency Rate | ₹ |
|---|---|---|
| Initial recognition US $ 27,250 (20,00,150/ 73.40) | 1 US $ = ₹ 73.40 | 20,00,150 |
| Rate on Balance sheet date | 1 US $ = ₹ 73.60 | |
| Exchange Difference Gain [US $ 27,250 X (73.60-73.40)] | | 5,450 |

As per AS 11 “The Effects of Changes in Foreign Exchange Rates”, exchange differences on trade receivables amounting ₹ 5,450 is required to be transferred to Profit and Loss A/c.

Treatment needed in this case: Credit Profit and loss account by ₹ 5,450.

# AS 12: Accounting for Government Grants

## Question 140

*Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant amount is deducted from the value of fixed asset.*

(*Study Material*)

**Answer**

**Journal in the books of Z Ltd.**

| ***Year*** | ***Particulars*** | | ***₹ (Dr.)*** | ***₹ (Cr.)*** |
|---|---|---|---|---|
| 1st | Fixed Assets Account | Dr. | 50,00,000 | |
| | To Bank Account | | | 50,00,000 |
| | (Being Fixed Assets purchased) | | | |
| | Bank Account | Dr. | 10,00,000 | |
| | To Fixed Assets Account | | | 10,00,000 |

| Year | Particulars | | ₹ (Dr.) | ₹ (Cr.) |
|---|---|---|---|---|
| | (Being grant received from the government) | | | |
| | Depreciation Account | Dr. | 7,00,000 | |
| | To Fixed Assets Account | | | 7,00,000 |
| | (Being Depreciation charged on SLM) | | | |
| | Profit & Loss Account | Dr. | 7,00,000 | |
| | To Depreciation Account | | | 7,00,000 |
| | (Being Depreciation transferred to P/L Account) | | | |
| 2nd | Depreciation Account | Dr. | 7,00,000 | |
| | To Fixed Assets Account | | | 7,00,000 |
| | (Being Depreciation charged on SLM) | | | |
| | Profit & Loss Account | Dr. | 7,00,000 | |
| | To Depreciation Account | | | 7,00,000 |
| | (Being Depreciation transferred to P/L Account) | | | |

## Question 141

*Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant is treated as deferred income. (Study Material)*

**Answer**

**Journal in the books of Z Ltd.**

| Year | Particulars | | ₹ (Dr.) | ₹ (Cr.) |
|---|---|---|---|---|
| 1st | Fixed Assets Account | Dr. | 50,00,000 | |
| | To Bank Account | | | 50,00,000 |
| | (Being fixed assets purchased) | | | |
| | Bank Account | Dr. | 10,00,000 | |
| | To Deferred Government Grant Account | | | 10,00,000 |
| | (Being grant received from the government) | | | |
| | Depreciation Account | Dr. | 9,00,000 | |
| | To Fixed Assets Account | | | 9,00,000 |
| | (Being depreciation charged on SLM) | | | |
| | Profit & Loss Account | Dr. | 9,00,000 | |
| | To Depreciation Account | | | 9,00,000 |
| | (Being depreciation transferred to P/L Account) | | | |
| | Deferred Government Grants Account | Dr. | 2,00,000 | |
| | To Profit & Loss Account | | | 2,00,000 |
| | (Being proportionate government grant taken to P/L Account) | | | |
| 2nd | Depreciation Account | Dr. | 9,00,000 | |
| | To Fixed Assets Account | | | 9,00,000 |
| | (Being depreciation charged on SLM) | | | |
| | Profit & Loss Account | Dr. | 9,00,000 | |
| | To Depreciation Account | | | 9,00,000 |
| | (Being depreciation transferred to P/L Account) | | | |
| | Deferred Government Grant Account | Dr. | 2,00,000 | |
| | To Profit & Loss Account | | | 2,00,000 |
| | (Being proportionate government grant taken to P/L Account) | | | |

## Question 142

*Santosh Ltd. has received a grant of ₹8 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed ₹2 crores as dividend. Also, Santosh Ltd. received land free of cost from the State Government but it has not recorded it at all in the books as no money has been spent. In the light of AS 12 examine, whether the treatment of both the grants is correct.*

(*Study Material*)

**Answer**

As per AS 12 'Accounting for Government Grants', when government grant is received for a specific purpose, it should be utilised for the same. So the grant received for setting up a factory is not available for distribution of dividend.

In the second case, even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value. The treatment of both the elements of the grant is incorrect as per AS 12.

## Question 143

*Top & Top Limited has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment, for which no repayment was ordinarily expected. Moreover, there was no condition that the company should purchase any specified assets for this subsidy. Having fulfilled all the conditions under the scheme, the company on its investment of ₹ 50 crore in capital assets received ₹ 10 crore from the Government in January, 20X2 (accounting period being 20X1-20X2). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 20X2.*

*Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.*

(*Study Material*)

**Answer**

As per para 10 of AS 12 'Accounting for Government Grants', where the government grants are of the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus, it is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs. The correct treatment is to credit the subsidy to capital reserve. Therefore, the accounting treatment desired by the company is not proper.

## Question 144

*How would you treat the following in the accounts in accordance with AS 12 'Government Grants'?*

*(i) ₹ 35 Lakhs received from the Local Authority for providing Medical facilities to the employees.*

*(ii) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in notified backward area. This subsidy is in nature of nature of promoters' contribution.*

(*Study Material*)

**Answer**

(i) ₹ 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively,₹ 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

(ii) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of ₹ 100 lakhs should be credited to capital reserve.

## Question 145

*Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs (This amount was reduced from the cost of fixed asset). Grant was considered as refundable in the end of 2nd year to the extent of ₹ 7,00,000. Pass the journal entry for refund of the grant as per the first method.*

(*Study Material*)

**Answer**

| | | |
|---|---|---|
| Fixed Assets Account | Dr. | ₹ 7,00,000 |
| To Bank Account | | ₹ 7,00,000 |
| (Being government grant on asset refunded) | | |

## Question 146

*A fixed asset is purchased for ₹ 20 lakhs. Government grant received towards it is ₹ 8 lakhs. Residual Value is ₹ 4 lakhs and useful life is 4 years. Assume depreciation on the basis of Straight Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of ₹ 5 lakhs due to non-compliance with certain conditions. Pass journal entries for first two years.*

(*Study Material*)

**Answer**

**Journal Entries**

| *Year* | *Particulars* | | *₹ in lakhs (Dr.)* | *₹ in lakhs (Cr.)* |
|---|---|---|---|---|
| 1 | Fixed Asset Account | Dr. | 20 | |
| | To Bank Account | | | 20 |
| | (Being fixed asset purchased) | | | |
| | Bank Account | Dr. | 8 | |
| | To Fixed Asset Account | | | 8 |
| | (Being grant received from the government reduced the cost of fixed asset) | | | |
| | Depreciation Account (W.N.1) | Dr. | 2 | |
| | To Fixed Asset Account | | | 2 |
| | (Being depreciation charged on Straight Line method (SLM)) | | | |
| | Profit & Loss Account | Dr. | 2 | |
| | To Depreciation Account | | | 2 |
| | (Being depreciation transferred to Profit and Loss Account at the end of year 1) | | | |
| 2 | Fixed Asset Account | Dr. | 5 | |
| | To Bank Account | | | 5 |
| | (Being government grant on asset partly refunded which increased the cost of fixed asset) | | | |
| | Depreciation Account (W.N.2) | Dr. | 3.67 | |
| | To Fixed Asset Account | | | 3.67 |
| | (Being depreciation charged on SLM on revised value of fixed asset prospectively) | | | |
| | Profit & Loss Account | Dr. | 3.67 | |
| | To Depreciation Account | | | 3.67 |
| | (Being depreciation transferred to Profit and Loss Account at the end of year 2) | | | |

**Working Notes:**

**1. Depreciation for Year 1**

| | *₹ in lakhs* |
|---|---:|
| Cost of the Asset | 20 |
| *Less:* Government grant received | (8) |
| | 12 |
| Depreciation $\left[\frac{12 - 4}{4}\right]$ | 2 |

**2. Depreciation for Year 2**

| | *₹ in lakhs* |
|---|---:|
| Cost of the Asset | 20 |
| Less: Government grant received | (8) |
| | 12 |
| Less: Depreciation for the first year $\left[\frac{12 - 4}{4}\right]$ | 2 |
| | 10 |
| Add: Government grant refundable | 5 |
| | 15 |
| Depreciation for the second year $\left[\frac{15 - 4}{3}\right]$ | 3.67 |

## Similar Question

**Question 146A**

A fixed asset is purchased for ₹ 30 lakhs. Government grant received towards it is ₹ 12 lakhs. Residual Value is ₹ 6 lakhs and useful life is 4 years. The company charges depreciation based on Straight-Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of ₹ 7.5 lakhs due to non-compliance with certain conditions. You are required to give necessary journal entries for second year.

*(RTP May, 2022)*

**Answer**

**Journal Entries**

| *Year* | *Particulars* | | *₹ in lakhs (Dr.)* | *₹ in lakhs (Cr.)* |
|---|---|---|---:|---:|
| 2nd | Fixed Asset Account | Dr. | 7.5 | |
| | To Bank Account | | | 7.5 |
| | (Being government grant on asset partly refunded which increased the cost of fixed asset) | | | |
| | Depreciation Account (W.N.) | Dr. | 5.5 | |
| | To Fixed Asset Account | | | 5.5 |
| | (Being depreciation charged on SLM on revised value of fixed asset prospectively) | | | |
| | Profit & Loss Account | Dr. | 5.5 | |
| | To Depreciation Account | | | 5.5 |
| | (Being depreciation transferred to Profit and Loss Account at the end of year 2) | | | |

**Working Note:**

**Depreciation for Year 2**

| | *₹ in lakhs* |
|---|---:|
| Cost of the Asset | 30 |
| *Less:* Government grant received | (12) |
| | 18 |
| *Less:* Depreciation for the first year $\left[\frac{18-6}{4}\right]$ | 3 |
| | 15 |
| *Add:* Government grant refundable | 7.5 |
| | 22.5 |
| Depreciation for the second year $\left[\frac{22.5-6}{3}\right]$ | |

## Question 147

*On 1.4.20X1, ABC Ltd. received Government grant of ₹ 300 lakhs for acquisition of machinery costing ₹ 1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 20X4 due to non-fulfillment of certain conditions.*

*How you would deal with the refund of grant in the books of ABC Ltd. assuming that the company did not charge any depreciation for year 20X4?*

(*Study Material*)

**Answer**

According to para 21 of AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing deferred income balance, as appropriate, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

| | | ***(₹ in lakhs)*** |
|---|---|---:|
| 1st April, 20X1 | Acquisition cost of machinery (₹ 1,500 –₹ 300) | 1,200.00 |
| 31st March, 20X2 | Less: Depreciation @ 20% | (240.00) |
| | Book value | 960.00 |
| 31st March, 20X3 | Less: Depreciation @ 20% | (192.00) |
| | Book value | 768.00 |
| 31st March, 20X4 | Less: Depreciation @ 20% | (153.60) |
| 1st April, 20X4 | Book value | 614.40 |
| May, 20X4 | Add: Refund of grant | 300.00 |
| | Revised book value | 914.40 |

Depreciation @ 20% on the revised book value amounting ₹ 914.40 lakhs is to be provided prospectively over the residual useful life of the asset.

## Question 148

*A Ltd. purchased a machinery for ₹ 40 lakhs. (Useful life 4 years and residual value₹ 8 lakhs) Government grant received is ₹ 16 lakhs.*

*Show the Journal Entry to be passed at the time of refund of grant in the third year and the value of the fixed assets, if:*

*(1) the grant is credited to Fixed Assets A/c.*

*(2) the grant is credited to Deferred Grant A/c.*

(*Study Material*)

**Answer**

**In the books of A Ltd.**

**Journal Entries (at the time of refund of grant)**

**(1) If the grant is credited to Fixed Assets Account:**

| | | ₹ | ₹ |
|---|---|---|---|
| I | Fixed Assets A/c Dr.<br>To Bank A/c<br>(Being grant refunded)<br>The amount of refund should be ₹ 16 Lakhs | 16 lakhs | 16 lakhs |
| II | The balance of fixed assets after two years depreciation will be ₹16 lakhs (W.N.1) and after refund of grant it will become (₹16 lakhs + ₹16 lakhs) = ₹32 lakhs on which depreciation will be charged for remaining two years. Depreciation = (32-8)/2 = ₹12 lakhs p.a. will be charged for next two years. | | |

Therefore, on refund in the 3rd year, following entry will be passed:

| | | ₹ | ₹ |
|---|---|---|---|
| I | Deferred Grant A/c Dr.<br>Profit & Loss A/c Dr.<br>To Bank A/c<br>(Being Government grant refunded) | 8 lakhs<br>8 lakhs | <br><br>16 lakhs |
| II | Deferred grant account will become Nil. The fixed assets will continue to be shown in the books at ₹24 lakhs (W.N.2) and depreciation will continue to be charged at ₹8 lakhs per annum for the remaining two years. | | |

**Working Notes:**

1. **Balance of Fixed Assets after two years but before refund (under first alternative)**

   Fixed assets initially recorded in the books = ₹40 lakhs – ₹16 lakhs =

   ₹24 lakhs

   Depreciation p.a. = (₹24 lakhs – ₹8 lakhs)/4 years = ₹4 lakhs per year

   Value of fixed assets after two years but before refund of grant

   = ₹24 lakhs – (₹4 lakhs x 2 years) = ₹16 lakhs

2. **Balance of Fixed Assets after two years but before refund (under second alternative)**

   Fixed assets initially recorded in the books = ₹40 lakhs

   Depreciation p.a. = (₹40 lakhs – ₹8 lakhs)/4 years = ₹8 lakhs per year

   Book value of fixed assets after two years = ₹40 lakhs – (₹8 lakhs x 2 years)

   = ₹24 lakhs

# QUESTION BANK

## Question 149

State whether the following statements are 'True' or 'False'. Also give reason for your answer.

As per the provisions of AS-12, government grants in the nature of promoters' contribution which become refundable should be reduced from the capital reserve. (*May 2019*) (*1 Marks*)

**Answer**

**True:** When grants in the nature of promoters' contribution becomes refundable, in part or in full to the government on non-fulfillment of some specified conditions, the relevant amount refundable to the government is reduced from the capital reserve.

## Question 150

On 01.04.2014, XYZ Ltd. received Government grant of ₹100 Lakhs for an acquisition of new machinery costing ₹500 lakhs. The grant was received and credited to the cost of the assets. The life span of the machinery is 5 years. The machinery is depreciated at 20% on WDV method.

The company had to refund the entire grant in 2nd April, 2017 due to non-fulfilment of certain conditions which was imposed by the government at the time of approval of grant.

How do you deal with the refund of grant to the Government in the books of XYZ Ltd., as per AS 12?

(*May 2018*) (*MTP March, 2022)* (*5 Marks*)

**Answer**

According to AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset (if the grant had been credited to the cost of fixed asset at the time of receipt of grant) should be recorded by increasing the book value of the asset, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

| | | **(₹ in lakhs)** |
|---|---|---|
| 1st April, 2014 | Acquisition cost of machinery (₹ 500 - ₹ 100) | 400.00 |
| 31st March, 2015 | Less: Depreciation @ 20% | (80) |
| 1st April, 2015 | Book value | 320.00 |
| 31st March, 2016 | Less: Depreciation @ 20% | (64) |
| 1st April, 2016 | Book value | 256.00 |
| 31st March, 2017 | Less: Depreciation @ 20% | (51.20) |
| 1st April, 2017 | Book value | 204.80 |
| 2nd April, 2017 | Add: Refund of grant | 100.00 |
| | Revised book value | 304.80 |

Depreciation @ 20% on the revised book value amounting ₹ 304.80 lakhs is to be provided prospectively over the residual useful life of the asset.

## Question 151

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2014- 15 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet and was not deducted from the cost of plant. During 2017-18, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2017-18 in profit and loss account?

(*RTP May 2019*)

**Answer:**

As per AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2017-18. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

## Question 152

A specific government grant of ₹ 15 lakhs was received by USB Ltd. for acquiring the Hi-Tech Diary plant of ₹ 95 lakhs during the year 2014-15. Plant has useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2017-18, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 10.50 lakhs and written down value of plant was ₹ 66.50 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of plant and the amount of depreciation to be charged during the year 2017-18 in profit and loss account?

(ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2014-15 assuming plant account showed the balance of ₹ 56 lakhs as on 1.4.2017?

You are required to explain in the line with provisions of AS 12. (*RTP November 2018*)

**Answer:**

As per para 21 of AS 12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

(i) In this case the grant refunded is ₹ 15 lakhs and balance in deferred income is ₹10.50 lakhs, ₹ 4.50 lakhs shall be charged to the profit and loss account for the year 2017-18. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

(ii) If the grant was deducted from the cost of the plant in the year 2014-15 then, para 21 of AS 12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by ₹ 15 lakhs. The increased cost of ₹ 15 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2017-18 shall be (56 + 15)/7 years = ₹ 10.14 lakhs presuming the depreciation is charged on SLM.

## Question 153

D Ltd. acquired a machine on 01-04-2012 for ₹ 20,00,000. The useful life is 5 years. The company had applied on 01-04-2012, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 2015. The Company's Fixed Assets Account for the financial year 2015-16 shows a credit balance as under:

| Particulars | ₹ |
|---|---|
| Machine (Original Cost) | 20,00,000 |
| Less: Accumulated Depreciation (from 2012-13- to 2014-15 on Straight Line Method) | 12,00,000 |
| | 8,00,000 |
| Less: Grant received | (16,00,000) |
| Balance | (8,00,000) |

You are required to explain how should the company deal with this asset in its accounts for 2015-16?

(*RTP May 2018*)

**Answer:**

From the above account, it is inferred that the Company follows Reduction Method for accounting of Government Grants. Accordingly, out of the ₹ 16,00,000 that has been received, ₹8,00,000 (being the balance in Machinery A/c) should be credited to the machinery A/c.

The balance ₹ 8,00,000 may be credited to P&L A/c, since already the cost of the asset to the tune of ₹ 12,00,000 had been debited to P&L A/c in the earlier years by way of depreciation charge, and ₹ 8,00,000 transferred to P&L A/c now would be partial recovery of that cost.

There is no need to provide depreciation for 2015-16 or 2016-17 as the depreciable amount is now Nil.

## Question 154

Ram Ltd. purchased machinery for ₹ 80 lakhs (useful life 4 years and residual value ₹ 8 lakhs). Government grant received was ₹ 32 lakhs. The grant had to be refunded at the beginning of third year. Show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if the g rant had been credited to Deferred Grant A/c.

(*MTP April 2019*)/(*MTP April, 2022) (5 Marks)*

**Answer**

As per AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (₹ 32 lakhs /4 years) = ₹ 8 lakhs x 2 years= ₹ 16 lakhs will be credited to Profit and Loss Account and ₹ 16 lakhs will be the balance of Deferred Grant Account after two years. Therefore, on refund of grant, following entry will be passed:

| | | ₹ lakhs | ₹ lakhs |
|---|---|---|---|
| Deferred Grant A/c | Dr. | 16 | |
| Profit & Loss A/c | Dr. | 16 | |
| To Bank A/c | | | 32 |
| (Being Government grant refunded) | | | |

1. **Value of Fixed Assets after two years but before refund of grant**
   Fixed assets initially recorded in the books = ₹ 80 lakhs
   Depreciation for each year = (₹ 80 lakhs – ₹8 lakhs)/4 years = ₹ 18 lakhs per year
   Book value of fixed assets after two years = ₹ 80 lakhs – (₹ 18 lakhs x 2 years) = ₹ 44 lakhs
2. **Value of Fixed Assets after refund of grant**
   On refund of grant the balance of deferred grant account will become nil. The fixed assets will continue to be shown in the books at ₹ 44 lakhs.
3. **Amount of depreciation for remaining two years**
   Depreciation will continue to be charged at ₹ 18 lakhs per annum for the remaining two years.

## Question 155

Samrat Limited has set up its business in a designated backward area which entitles the company for subsidy of 25% of the total investment from Government of India. The company has invested ₹ 80 crores in the eligible investments. The company is eligible for the subsidy and has received ₹ 20 crores from the government in February 2019. The company wants to recognize the said subsidy as its income to improve the bottom line of the company.

Do you approve the action of the company in accordance with the Accounting Standard?

(*RTP November 2019*)

**Answer**

As per AS 12 "Accounting for Government Grants", where the government grants are in the nature of promoters' contribution, *i.e.,* they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, Central Investment Subsidy Scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

The subsidy received by Samrat Ltd. for setting up its business in a designated backward area will be treated as grant by the government in the nature of promoter's contribution as the grant is given with reference to the total investment in an undertaking i.e. subsidy is 25% of the eligible investment and also no repayment is apparently expected in respect thereof.

Since the subsidy received is neither in relation to specific fixed assets nor in relation to revenue. Thus, the company cannot recognize the said subsidy as income in its financial statements in the given case. It should be recognized as capital reserve which can be neither distributed as dividend nor considered as deferred income.

## Question 156

How would you treat the following in the accounts in accordance with AS 12 'Government Grants'?

(i) ₹ 35 Lakhs received from the Local Authority for providing Medical facilities to the employees.

(ii) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in a notified backward area.

(iii) ₹ 10 Lakhs Grant received from the Central Government on installation of anti- pollution equipment.

[*RTP May 2020*]

**Answer**

(i) ₹ 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in the nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, ₹ 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

(ii) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of ₹ 100 lakhs should be credited to capital reserve.

(iii) ₹ 10 lakhs grant received for installation anti-pollution equipment is a grant related to specific fixed asset. Two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives. Under first method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Under the second method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

Thus, ₹ 10 lakhs may either be deducted from the cost of equipment or treated as deferred income to be recognized on a systematic basis in profit & Loss A/c over the useful life of equipment.

## Question 157

How would you treat the following in the accounts in accordance with AS 12 'Government Grants'?

(i) ₹ 35 Lakhs received from the Local Authority for providing Medical facilities to the employees.

(ii) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in notified backward area.

[*RTP, November 2020*]

**Answer**

(i) ₹ 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in the nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, ₹ 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

(ii) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of ₹ 100 lakhs should be credited to capital reserve.

## Question 158

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2016- 17 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet and was not deducted from the cost of plant. During 2019-20, due to non- compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2019-20 in profit and loss account?

*(5 Marks) (MTP, May 2020)*

**Answer:**

As per AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2019-20. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

## Question 159

Ram Ltd. purchased machinery for ₹ 80 lakhs (useful life 4 years and residual value ₹ 8 lakhs). Government grant received was ₹ 32 lakhs. The grant had to be refunded at the beginning of third year. Show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if the grant had been credited to Deferred Grant A/c.

(*5 Marks*)

**Answer**

As per AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (₹ 32 lakhs /4 years) = ₹ 8 lakhs x 2 years= ₹ 16 lakhs will be credited to Profit and Loss Account and ₹16 lakhs will be the balance of Deferred Grant Account after two years. Therefore, on refund of grant, following entry will be passed:

| | | ₹ | ₹ |
|---|---|---|---|
| Deferred Grant A/c | Dr. | 16 lakhs | |
| Profit & Loss A/c | Dr. | 16 lakhs | |
| To Bank A/c | | | 32 lakhs |
| (Being Government grant refunded) | | | |

1. **Value of Fixed Assets after two years but before refund of grant**
   Fixed assets initially recorded in the books = ₹ 80 lakhs
   Depreciation for each year = (₹ 80 lakhs – ₹8 lakhs)/4 years = ₹ 18 lakhs per year
   Book value of fixed assets after two years = ₹ 80 lakhs – (₹ 18 lakhs x 2 years) = ₹ 44 lakhs
2. **Value of Fixed Assets after refund of grant**
   On refund of grant the balance of deferred grant account will become nil. The fixed assets will continue to be shown in the books at ₹ 44 lakhs.
3. **Amount of depreciation for remaining two years**
   Depreciation will continue to be charged at ₹ 18 lakhs per annum for the remaining two years.

## Question 160

Alps Limited has received the following Grants from the Government during the year ended 31st March, 2021:

(i) ₹120 Lacs received as Subsidy from the Central Government for setting up an Industrial undertaking in Medak, a notified backward area.

(ii) ₹15 Lacs Grant received from Central Government on installation of Effluent Treatment Plant.

(iii) ₹125 Lacs received from State Government for providing Medical facilities to its workmen during the pandemic.

Advise Alps Limited on the treatment of the above Grants in its books of Account in accordance with AS-12 "Government Grants". (*5 Marks*)

# Similar Question

## Question 160A

Suraj Limited provides you the following information:

(i) It received a Government Grant @40% towards the acquisition of Machinery worth ₹ 25 Crores,

(ii) It received a Capital Subsidy of ₹ 150 Lakhs from Government for setting up a Plant costing ₹ 300 Lakhs in a notified backward region;

(iii) It received ₹ 50 Lakhs from Government for setting up a project for supply of arsenic free water in a notified area.

(iv) It received ₹ 5 Lakhs from the Local Authority for providing Corona Vaccine free of charge to its employees and their families.

(v) It also received a performance award of ₹ 500 Lakhs from Government with a condition of major renovation in the Power Plant within 3 years. Suraj Limited incurred 90% of amount towards Capital expenditure and balance for Revenue Expenditure.

State, how you will treat the above in the books of Suraj Limited. (*Question Paper, May 2022*) (*5 Marks*)

## Question 161

(i) Hygiene Ltd. had received a grant of ₹ 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. The company, however, failed to comply with the said conditions and consequently was required to refund the said amount in 2020.

The company debited the said amount to its machinery account in 2020 on payment of the same. It also reworked the depreciation for the said machinery from the date of its purchase and passed necessary adjusting entries in the year 2020 to incorporate the retrospective impact of the same. State whether the treatment done by the company is correct or not.

(ii) ABC Ltd. received two acres of land received for set up of plant. It also received ₹2 lakhs received for purchase of machinery of ₹ 10 lakhs. Useful life of machinery is 5 years. Depreciation on this machinery is to be charged on straight-line basis. How should ABC Ltd. recognize these government grants in its books of accounts?

**Answer**

**(i)** As per the facts of the case, Hygiene Ltd. had received a grant of ₹ 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. However, the amount of grant has to be refunded since it failed to comply with the prescribed conditions. In such circumstances, AS 12, “Accounting for Government Grants”, requires that the amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. The Standard further makes it clear that in the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Accordingly, the accounting treatment given by Hygiene Ltd. of increasing the value of the plant and machinery is quite proper. However, the accounting treatment in respect of depreciation given by the company of adjustment of depreciation with retrospective effect is improper and constitutes violation of AS 12.

**(ii) ABC Ltd. should recognize the grants in the following manner:**

- As per AS 12, government grants may take the form of non-monetary assets, such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary assets given free of cost are recorded at a nominal value. Accordingly, land should be recognised at nominal value in the balance sheet.
- The standard provides option to treat the grant either as a deduction from the gross value of the asset or to treat it as deferred income as per provisions of the standard. Under first method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Accordingly, the grant of ₹ 2 lakhs is deducted from the cost of the machinery. Machinery will be recognised in the books at ₹ 10 lakhs – ₹ 2 lakhs = ₹ 8 lakhs and depreciation will be charged on it as follows: ₹ 8 lakhs/ 5 years = ₹ 1.60 lakhs per year.

Under the second method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged. ₹ 2 lakhs should be recognised as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, ₹ 40,000 [₹ 2 lakhs / 5 years] should be credited to profit and loss each year over the period of 5 years.

## Question 162

Darshan Ltd. purchased a Machinery on 1st April, 2016 for ₹ 130 lakhs (Useful life is 4Years). Government grant received is ₹ 40 lakhs for the purchase of above Machinery.

Salvage value at the end of useful life is estimated at ₹ 60 lakhs. Darshan Ltd. decides to treat the grant as deferred income.

Your are required to calculate the amount of depreciation and grant to be recognized in profit & loss account for the year ending 31st March, 2017,31st March, 2018, 31st March, 2019& 31st March, 2020.

Darshan Ltd. follows straight line method for charging depreciation.

(*5 marks*)

**Answer**

As per 12 “Accounting for government grants”, grants related to depreciable assets, if treated as deferred income are recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

**Amount of depreciation and grant to be recognized in the profit and loss account each year**

Depreciation per year:

| | **₹ in lakhs** |
|---|---:|
| Cost of the Asset | 130 |
| Less: Salvage value | (60) |
| | **70** |
| Depreciation per year **(**70lakhs/4) | 17.50 |

₹ 17.50 Lakhs depreciation will be recognized for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

Amount of grant recognized in Profit and Loss account each year:

40 lakhs /4 years = ₹ 10 Lakhs for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

## Question 163

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2016-17 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet and was not deducted from the cost of plant. During 2019-20, due to non- compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was

₹ 105 lakhs. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2019-20 in profit and loss account?

(*5 Marks*)

**Answer**

As per AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2019-20. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

## Question 164

Supriya Ltd. received a grant of ₹ 2,500 lakhs during the accounting year 20X1-20X2 from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilisation. However, during the year 20X2-20X3, it was found that the conditions of grants were not complied with and the grant had to be refunded to the government in full. Elucidate the current accounting treatment, with reference to the provisions of AS-12

(*Study Material*)

**Answer**

As per AS 12 'Accounting for Government Grants', Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5.

The amount refundable in respect of a government grant related to revenue is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

In the present case, the amount of refund of government grant should be shown in the profit & loss account of the company as an extraordinary item during the year.

## Question 165

On 01.04.2017, XYZ Ltd. received Government grant of ₹ 100 Lakhs for an acquisition of new machinery costing ₹ 500 lakhs. The grant was received and credited to the cost of the assets. The life span of the machinery is 5 years. The machinery is depreciated at 20% on WDV method. The company had to refund the entire grant in 2nd April, 2020 due to non-fulfilment of certain conditions which was imposed by the government at the time of approval of grant. How do you deal with the refund of grant to the Government in the books of XYZ Ltd. as per AS 12?

*(MTP, October, 2020)* (*5 Marks*)

**Answer**

According to AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset (if the grant had been credited to the cost of fixed asset at the time of receipt of grant) should be recorded by increasing the book value of the asset, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

| | | ***(₹ in lakhs)*** |
|---|---|---:|
| 1st April, 2017 | Acquisition cost of machinery (₹ 500 – ₹ 100) | 400.00 |
| 31st March, 2018 | *Less*: Depreciation @ 20% | (80) |
| 1st April, 2018 | Book value | 320.00 |
| 31st March, 2019 | *Less*: Depreciation @ 20% | (64) |
| 1st April, 2019 | Book value | 256.00 |
| 31st March, 2020 | *Less*: Depreciation @ 20% | (51.20) |
| 1st April, 2020 | Book value | 204.80 |
| 2nd April, 2020 | *Add*: Refund of grant | 100.00 |
| | Revised book value | 304.80 |

Depreciation @ 20% on the revised book value amounting ₹ 304.80 lakhs is to be provided prospectively over the residual useful life of the asset.

## Question 166

On 1st April, 2016, Mac Ltd. received a Government Grant of ₹ 60 lakhs for acquisition of machinery costing ₹ 300 lakhs. The grant was credited to the cost of the asset. The estimated useful life of the machinery is 10 years. The machinery is depreciated @ 10% on WDV basis. The company had to refund the grant in June 2019 due to non- compliance of certain conditions.

How the refund of the grant is dealt with in the books of Mac Ltd. assuming that the company did not charge any depreciation for the year 2019-20.

Pass necessary Journal Entries for the year 2019-20.

(*5 Marks*) (*November 2020*)

**Answer**

| | | (₹ in lakhs) |
|---|---|---|
| 1st April, 2016 | Acquisition cost of machinery Less: Government Grant | 300.00 |
| | | 60.00 |
| | | 240.00 |
| 31st March, 2017 | Less: Depreciation @ 10% | (24.00) |
| 1st April, 2017 | Book value | 216.00 |
| 31st March, 2018 | Less: Depreciation @ 10% | (21.60) |
| 1st April, 2018 | Book value | 194.40 |
| 31st March, 2019 | Less: Depreciation @ 10% | (19.44) |
| 1st April, 2019 | Book value | 174.96 |
| | Less: Depreciation @10% for 2 months | (2.916) |
| 1st June, 2019 | Book value | 172.044 |
| June 2019 | Add: Refund of grant* | 60.00 |
| | Revised book value | 232.044 |

Depreciation @10% on the revised book value amounting to ₹ 232.044 lakhs is to be provided prospectively over the residual useful life of the machinery.

*considered refund of grant at beginning of June month and depreciation for two months already charged. Alternative answer considering otherwise also possible.

**Journal Entries**

| | | | |
|---|---|---|---|
| Machinery Account | Dr. | 60 | |
| To Bank Account | | | 60 |
| (Being government grant on asset partly refunded which increased the cost of fixed asset) | | | |
| Depreciation Account | Dr. | 19.337 | |
| To Machinery Account | | | 19.337 |
| (Being depreciation charged on revised value of fixed asset prospectively for 10 months) | | | |
| Profit & Loss Account | Dr. | 22.253 | |
| To Depreciation Account | | | 22.253 |
| (Being depreciation transferred to Profit and Loss Account amounting to ₹ (2.916 + 19.337= 22.253) | | | |

## Question 167

Caseworker Limited received a specific grant of ₹ 6 crore for acquiring the plant of ₹ 30 crore during financial year 2015-2016 having useful life of 10 years. During the financial year 2020- 2021, due to non-compliance of conditions laid down for the grant of ₹ 6 crore, the company had to refund the grant to the Government. What should be the treatment of the refund if grant was deducted from the cost of the plant during financial year 2015-2016? Assume depreciation is charged on fixed assets as per Straight Line Method.

(*MTP, November, 2021*) (*5 Marks*)

**Answer**

As per AS 12, the amount refundable in respect of grant related to specific fixed assets should be recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, *as appropriate*, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

Where grant was deducted from the cost of the asset, initial value of the plant after deduction of grant amount of ₹ 6 crore would have been = ₹ 30 crore – ₹ 6 crore = ₹ 24 crore.

Carrying value of the plant after 5 years on 1.4.2020 = [(₹ 24 crore/10 years) x 5 years] = ₹ 12 crore.

Annual depreciation charge would be ₹ 2.4 crore.

On refund of grant to the Government, the book value of the plant shall be increased by ₹ 6 crore i.e. ₹ 12 crore + ₹ 6 crore = ₹ 18 crore. The increased cost of ₹ 18 crore of the plant should be amortised prospectively over remaining 5 years of useful residual life. Depreciation charge in the year 2020-2021 would be ₹ 18 crore/5 years = ₹ 3.6 crore instead of earlier ₹ 2.4 crore.

## Question 168

D Ltd. acquired a machine on 01-04-2017 for ₹ 20,00,000. The useful life is 5 years. The company had applied on 01-04-2017, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 2020. The Company's Fixed Assets Account for the financial year 2020-21 shows a credit balance as under:

| Particulars | ₹ |
|---|---|
| Machine (Original Cost) | 20,00,000 |
| *Less:* Accumulated Depreciation (from 2017-18- to 2019-20 on Straight Line Method) | 12,00,000 |
| | 8,00,000 |
| *Less:* Grant received | (16,00,000) |
| Balance | (8,00,000) |

You are required to explain how should the company deal with this asset in its accounts for 2020-21?

(*RTP, November 2021*)

**Answer**

From the above account, it is inferred that the Company has deducted grant from the book value of asset for accounting of Government Grants. Accordingly, out of the ₹ 16,00,000 that has been received, ₹ 8,00,000 (being the balance in Machinery A/c) should be credited to the machinery A/c.

The balance ₹ 8,00,000 may be credited to P&L A/c, since already the cost of the asset to the tune of ₹ 12,00,000 had been debited to P&L A/c in the earlier years by way of depreciation charge, and ₹ 8,00,000 transferred to P&L A/c now would be partial recovery of that cost.

There is no need to provide depreciation for 2020-21 or 2021-22 as the depreciable amount is now Nil.

# AS 16: Borrowing Costs

## Question 188

*PRM Ltd. obtained a loan from a bank for ₹ 50 lakhs on 30-04-20X1. It was utilised as follows:*

| ***Particulars*** | ***Amount (₹ in lakhs)*** |
|---|---|
| *Construction of a shed* | *50* |
| *Purchase of a machinery* | *40* |
| *Working Capital* | *20* |
| *Advance for purchase of truck* | *10* |

*Construction of shed was completed in March 20X2. The machinery was installed on the date of acquisition. Delivery of truck was not received. Total interest charged by the bank for the year ending 31-03-20X2 was ₹ 18 lakhs. Show the treatment of interest.*

(*Study Material*)

**Answer**

Qualifying Asset as per AS 16 = ₹ 50 lakhs (construction of a shed)

Borrowing cost to be capitalised = 18 x 50/120 = ₹ 7.5 lakhs

Interest to be debited to Profit or Loss account = ₹ (18 – 7.5) lakhs = ₹ 10.5 lakhs

## Question 189

*X Ltd. began construction of a new building on 1st January, 20X1. It obtained ₹ 1 lakh special loan to finance the construction of the building on 1st January, 20X1 at an interest rate of 10%. The company's other outstanding two non-specific loans were:*

| ***Amount*** | ***Rate of Interest*** |
|---|---|
| *₹ 5,00,000* | *11%* |
| *₹ 9,00,000* | *13%* |

*The expenditures that were made on the building project were as follows:*

| | | ***₹*** |
|---|---|---|
| *January* | *20X1* | *2,00,000* |
| *April* | *20X1* | *2,50,000* |
| *July* | *20X1* | *4,50,000* |
| *December* | *20X1* | *1,20,000* |

*Building was completed by 31st December 20X1. Following the principles prescribed in AS 16 'Borrowing Cost,' calculate the amount of interest to be capitalised and pass one Journal Entry for capitalising the cost and borrowing cost in respect of the building.*

(*Study Material*)

**Answer**

**(i) Computation of weighted average accumulated expenses**

| | | ₹ |
|---|---|---|
| ₹ 2,00,000 x 12 / 12 | = | 2,00,000 |
| ₹ 2,50,000 x 9 / 12 | = | 1,87,500 |
| ₹ 4,50,000 x 6 / 12 | = | 2,25,000 |
| ₹ 1,20,000 x 1 / 12 | = | 10,000 |
| | | 6,22,500 |

**(ii) Calculation of weighted average interest rate other than for specific borrowings**

| Amount of loan (₹ ) | Rate of interest | | Amount of interest (₹) |
|---|---|---|---|
| 5,00,000 | 11% | = | 55,000 |
| 9,00,000 | 13% | = | 1,17,000 |
| 14,00,000 | | | 1,72,000 |
| Weighted average rate of interest $\left(\frac{1,72,000}{14,00,000} \times 100\right)$ | | = | 12.285% (approx) |

**(iii) Interest on weighted average accumulated expenses**

| | | ₹ |
|---|---|---|
| Specific borrowings (₹ 1,00,000 x 10%) | = | 10,000 |
| Non-specific borrowings (₹ 5,22,500* x 12.285%) | = | 64,189 |
| Amount of interest to be capitalised | = | 74,189 |

**(iv) Total expenses to be capitalised for building**

| | ₹ |
|---|---|
| Cost of building ₹ (2,00,000 + 2,50,000 + 4,50,000 + 1,20,000) | 10,20,000 |
| *Add:* Amount of interest to be capitalised | 74,189 |
| | 10,94,189 |

**(v) Journal Entry**

| Date | Particulars | | Dr. (₹) | Cr. (₹) |
|---|---|---|---|---|
| 31.12. 20X1 | Building account | Dr. | 10,94,189 | |
| | To Bank account | | | 10,94,189 |
| | (Being amount of cost of building and borrowing cost thereon capitalised) | | | |

* (₹ 6,22,500 – ₹ 1,00,000)

## Question 190

*The company has obtained Institutional Term Loan of ₹ 580 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 20X2 amounted to ₹ 406 lakhs, ₹ 58 lakhs has been advanced to suppliers for additional assets and the balance loan of ₹ 116 lakhs has been utilised for working capital purpose. The Accountant is on a dilemma as to how to account for the total interest of ₹ 52.20 lakhs incurred during 20X1-20X2 on the entire Institutional Term Loan of ₹ 580 lakhs.*

(*Study Material*)

**Answer**

As per para 6 of AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

A qualifying asset is an asset that necessary takes a substantial period of time* to get ready for its intended use or sale.

The treatment for total interest amount of ₹ 52.20 lakhs can be given as:

| ***Purpose*** | ***Nature*** | ***Interest to be capitalised*** | ***Interest to be charged to profitand loss account*** |
|---|---|---|---|
| | | ***₹ in lakhs*** | ***₹ in lakhs*** |
| Modernisation and renovation of plant and machinery | Qualifying asset | $** 52.20 \times \frac{406}{580} = 36.54$<br>$** 52.20 \times \frac{58}{580} = 5.22$ | |
| Advance to supplies for additional assets | Qualifying asset | | $** 52.20 \times \frac{116}{580} = 10.44$ |
| Working Capital | Not a qualifying asset | | |
| | | 41.76 | 10.44 |

** A substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case.*

*** It is assumed in the above solution that the modernisation and renovation of plant and machinery will take substantial period of time (i.e. more than twelve months). Regarding purchase of additional assets, the nature of additional assets has also been considered as qualifying assets. Alternatively, the plant and machinery and additional assets may be assumed to be non-qualifying assets on the basis that the renovation and installation of additional assets will not take substantial period of time. In that case, the entire amount of interest, ₹ 52.20 lakhs will be recognised as expense in the profit and loss account for year ended 31st March, 20X2.*

## Question 191

*Take Ltd. has borrowed ₹ 30 lakhs from State Bank of India during the financial year 20X1-20X2. The borrowings are used to invest in shares of Give Ltd., a subsidiary company of Take Ltd., which is implementing a new project, estimated to cost ₹ 50 lakhs. As on 31st March, 20X2, since the said project was not complete, the directors of Take Ltd. resolved to capitalise the interest accruing on borrowings amounting to ₹ 4 lakhs and add it to the cost of investments. Comment.*

(*Study Material*)

**Answer**

As per AS 13 (Revised) "Accounting for Investments", the cost of investment includes acquisition charges such as brokerage, fees and duties. In the present case, Take Ltd. has used borrowed funds for purchasing shares of its subsidiary company Give Ltd. ₹ 4 lakhs interest payable by Take Ltd. to State Bank of India cannot be called as acquisition charges, therefore, cannot be constituted as cost of investment.

Further, as per para 3 of AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Since, shares are ready for its intended use at the time of sale, it cannot be considered as qualifying asset that can enable a company to add the borrowing cost to investments. Therefore, the directors of Take Ltd. cannot capitalise the borrowing cost as part of cost of investment. Rather, it has to be charged to the Statement of Profit and Loss for the year ended 31st March, 20X2.

# QUESTION BANK

## Question 192

M/s First Ltd. began construction of a new factory building on 1st April, 2017. It obtained ₹ 2,00,000 as a special loan to fiancé the construction of the factory building on 1st April, 2017 at an interest rate of 8% per annum. Further expenditure on construction of the factory building was financed through other non-specific loans. Details of other outstanding non-specific loans were:

| Amount (₹) | Rate of Interest per annum |
|---|---|
| 4,00,000 | 9% |
| 5,00,000 | 12% |
| 3,00,000 | 14% |

The expenditures that were made on the factory building construction were as follows:

| Date | Amount (₹) |
|---|---|
| 1st April, 2017 | 3,00,000 |
| 31st May, 2017 | 2,40,000 |
| 1st August, 2017 | 4,00,000 |
| 31st December, 2017 | 3,60,000 |

The construction of factory building was completed by 31st March, 2018. As per the provisions of AS-16, you are required to:

(1) Calculate the amount of interest to be capitalized.

(2) Pass Journal entry for capitalizing the cost and borrowing cost in respect of the factory building.

(*May 2019*) (*5 Marks*)

**Answer**

**(i) Computation of average accumulated expenses**

| | | ₹ |
|---|---|---|
| ₹ 3,00,000 x 12 / 12 | = | 3,00,000 |
| ₹ 2,40,000 x 10 / 12 | = | 2,00,000 |
| ₹ 4,00,000 x 8 / 12 | = | 2,66,667 |
| ₹ 3,60,000 x 3 / 12 | = | 90,000 |
| | | 8,56,667 |

**(ii) Calculation of average interest rate other than for specific borrowings**

| Amount of loan (₹) | Rate of interest | | Amount of interest (₹) |
|---|---|---|---|
| 4,00,000 | 9% | = | 36,000 |
| 5,00,000 | 12% | = | 60,000 |
| 3,00,000 | 14% | = | 42,000 |
| | | | 1,38,000 |
| Weighted average rate of interest $\left(\frac{1,38,000}{12,00,000}\times 100\right)$ | | = | 11.5% |

**(iii) Amount of interest to be capitalized**

| | | ₹ |
|---|---|---|
| Interest on average accumulated expenses: | | |
| Specific borrowings (₹ 2,00,000 x 8%) | = | 16,000 |
| Non-specific borrowings (₹ 6,56,667* x 11.5%) | = | 75,517 |
| Amount of interest to be capitalized | = | 91,517 |

* (₹ 8,56,667 – ₹ 2,00,000)

**(iv) Total expenses to be capitalised for building**

| | ₹ |
|---|---:|
| Cost of building ₹ (3,00,000 + 2,40,000 + 4,00,000 + 3,60,000) | 13,00,000 |
| *Add:* Amount of interest to be capitalized | 91,517 |
| | 13,91,517 |

**(v) Journal Entry**

| Date | Particulars | | Dr. (₹) | Cr. (₹) |
|---|---|---|---|---:|
| 31.3.2018 | Building A/c | Dr. | 13,91,517 | |
| | To Building WIP** A/c | | | 13,00,000 |
| | To Borrowing costs A/c | | | 91,517 |
| | (Being amount of cost of building and borrowing cost thereon capitalised) | | | |

*** Considering that ₹ 13,00,000 was debited to Building WIP A/c earlier.*

## Similar Question

### Question 192A

Zebra Limited began construction of a new plant on 1st April, 2021 and obtained a special loan of ₹ 20,00,000 to finance the construction of the plant. The rate of interest on loan was 10%.

The expenditure that was incurred on the construction of plant was as follows:

| | ₹ |
|---|---:|
| 1st April, 2021 | 10,00,000 |
| 1st August, 2021 | 24,00,000 |
| 1st January, 2022 | 4,00,000 |

The company's other outstanding non-specific loan was ₹ 46,00,000 at an interest rate of 12%.

The construction of the plant completed on 31st March, 2022.

**You are required to:**

(a) Calculate the amount of interest to be capitalized as per the provisions of AS-16 "Borrowing Cost".

(b) Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant.

(*Question Paper, May 2022*) (*5 Marks*)

### Question 193

Zen Bridge Construction Limited obtained a loan of ₹ 64 crores to be utilized as under:

| | | |
|---|---|---:|
| (i) | Construction of Hill link road in Kedarnath | ₹ 50 crores |
| (ii) | Purchase of Equipment and Machineries | ₹ 6 crores |
| (iii) | Working Capital | ₹ 4 crores |
| (iv) | Purchase of Vehicles | ₹ 1crore |
| (v) | Advances for tools/cranes etc . | ₹ 1crore |
| (vi) | Purchase of Technical Know how | ₹ 2 crores |
| (vii) | Total Interest charged by the Bank for the year ending 31st March, 2018 | ₹ 1.6 crores |

Show the treatment of Interest according to Accounting Standard by Zen Bridge Construction Limited.

(*RTP May 2019*)

**Answer:**

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use. As per the standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

The treatment of interest by Zen Bridge Construction Ltd. can be shown as:

| | ***Qualifying Asset*** | ***Interest to be capitalized ₹ in crores*** | ***Interest to be charged to Profit & Loss A/c ₹ in crores*** | |
|---|---:|---:|---:|---:|
| Construction of hill road* | Yes | 1.25 | | 1.6/64 x 50 |
| Purchase of equipment and machineries | No | | 0.15 | 1.6/64 x 6 |

| | ***Qualifying Asset*** | ***Interest to be capitalized ₹ in crores*** | ***Interest to be charged to Profit & Loss A/c ₹ in crores*** | |
|---|---|---|---|---|
| Working capital | No | | 0.10 | 1.6/64 x 4 |
| Purchase of vehicles | No | | 0.025 | 1.6/64 x 1 |
| Advance for tools, cranes etc. | No | | 0.025 | 1.6/64 x 1 |
| Purchase of technical know-how | No | | 0.05 | 1.6/64 x 2 |
| Total | | 1.25 | 0.35 | |

***Note:** It is assumed that construction of hill road will normally take more than a year (substantial period of time), hence considered as qualifying asset.

## Question 194

A company incorporated in June 2017, has setup a factory within a period of 8 months with borrowed funds. The construction period of the assets had reduced drastically due to usage of technical innovations by the company. Whether interest on borrowings for the period prior to the date of setting up the factory should be capitalized although it has taken less than 12 months for the assets to get ready for use. You are required to comment on the necessary treatment with reference to AS 16.

(*RTP November 2018*) (*MTP April, 2022*) (*5 Marks*)

**Answer:**

As per para 3.2 to AS 16 'Borrowing Costs', a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Further, Explanation to the above para states that what constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

It may be implied that there is a rebuttable presumption that a 12 months period constitutes substantial period of time.

Under present circumstances where construction period has reduced drastically due to technical innovation, the 12 months period should at best be looked at as a benchmark and not as a conclusive yardstick. It may so happen that an asset under normal circumstances may take more than 12 months to complete. However, an enterprise that completes the asset in 8 months should not be penalized for its efficiency by denying it interest capitalization and vice versa.

The substantial period criteria ensures that enterprises do not spend a lot of time and effort capturing immaterial interest cost for purposes of capitalization.

Therefore, if the factory is constructed in 8 months then it shall be considered as a qualifying asset. The interest on borrowings for the same shall be capitalised although it has taken less than 12 months for the asset to get ready to use.

## Question 195

In May, 2016, Capacity Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2017 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2017 amounted to ₹ 25 lakhs.

Can ₹ 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

(*RTP May 2018*)

**Answer:**

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2017) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

## Question 196

Omega Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2016-17 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment exchange rate was ₹ 56 per US $ and the rate as on31st March, 2017 was ₹ 62 per US $. If Omega Limited borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%.

You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2017 as per applicable Accounting Standards.

(*MTP March 2019*) (*5 Marks*)

**Answer:**

(i) Interest for the period 2016-17
= US $ 10 lakhs x 4% × ₹ 62 per US$ = ₹ 24.80 lakhs

(ii) Increase in the liability towards the principal amount
= US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11.

## Question 197

Suhana Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.05.2016, to be utilized as under:

| **Particulars** | **Amount (₹ in lakhs)** |
|---|---|
| Construction of factory building | 40 |
| Purchase of Machinery | 35 |
| Working Capital | 25 |

In March 2017, construction of the factory building was completed and machinery was installed and ready for it's intended use. Total interest on debentures for the financial year ended 31.03.2017 was ₹11,00,000. During the year 2016-17, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹2,00,000.

Explain the treatment of interest under Accounting Standard 16 and also explain nature of assets.

(*MTP August, 2018*) (*5 Marks*)

**Answer**

As per AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

Also AS 16 "Borrowing Costs" states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost
= ₹ 11,00,000 – ₹ 2,00,000
= ₹ 9,00,000

| **Sr. No.** | **Particulars** | **Nature of assets** | **Interest to be Capitalized (₹)** | **Interest to be charged to Profit & Loss Account (₹)** |
|---|---|---|---|---|
| (i) | Construction of factory building | Qualifying Asset* | 9,00,000x40/100 = ₹ 3,60,000 | NIL |
| (ii) | Purchase of Machinery | Not a Qualifying Asset | NIL | 9,00,000 x 35/100 = ₹ 3,15,000 |
| (iii) | Working Capital | Not a Qualifying Asset | NIL | 9,00,000 x 25/100 = ₹ 2,25,000 |
| | Total | | ₹ 3,60,000 | ₹ 5,40,000 |

* A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

## Question 198

Suhana Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.05.2016, to be utilized as under:

| ***Particulars*** | ***Amount (₹ in lakhs)*** |
|---|---|
| Construction of factory building | 40 |
| Purchase of Machinery | 35 |
| Working Capital | 25 |

In March 2017, construction of the factory building was completed and machinery was installed and ready for it's intended use. Total interest on debentures for the financial year ended 31.03.2017 was ₹ 11,00,000. During the year 2016 -17, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹ 2,00,000.

Show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

(*MTP October, 2018*) (*5 Marks*)

**Answer:**

According to AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= ₹ 11,00,000 – ₹ 2,00,000

= ₹ 9,00,000

| *Sr. No.* | *Particulars* | *Nature of assets* | *Interest to be Capitalized (₹)* | *Interest to be charged to Profit & Loss Account (₹)* |
|---|---|---|---|---|
| (i) | Construction of factory building | Qualifying Asset* | 9,00,000x40/100 = ₹ 3,60,000 | NIL |
| (ii) | Purchase of Machinery | Not a Qualifying Asset | NIL | 9,00,000x35/100 = ₹ 3,15,000 |
| (iii) | Working Capital | Not a Qualifying Asset | NIL | 9,00,000x25/100 = ₹ 2,25,000 |
| | Total | | ₹ 3,60,000 | ₹ 5,40,000 |

* A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

## Question 199

Omega Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2016-17 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2017 was ₹ 62 per US $. If Omega Limited borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%.

You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2017 as per applicable Accounting Standards.

(*MTP March 2018*) (*5 Marks*)

**Answer**:

(i) Interest for the period 2016-17
= US $ 10 lakhs x 4% x ₹ 62 per US$ = ₹ 24.80 lakhs

(ii) Increase in the liability towards the principal amount
= US $ 10 lakhs x ₹ (62 - 56) = ₹60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 10 lakhs x ₹56 x 10.5% = ₹ 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing
= ₹58.80 lakhs 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11.

## Question 200

Zen Bridge Construction Limited obtained a loan of ₹ 64 crores to be utilized as under:

| | | |
|---|---|---|
| (i) | Construction of Hill link road in Kedarnath: (work was held up totally for a month during the year due to heavy rain which are common in the geographic region involved) | ₹ 50 crores |
| (ii) | Purchase of Equipment and Machineries | ₹ 6 crores |
| (iii) | Working Capital | ₹ 4 crores |
| (iv) | Purchase of Vehicles | ₹ Icrore |
| (v) | Advances for tools/cranes etc. | ₹ Icrore |
| (vi) | Purchase of Technical Know how | ₹ 2 crores |
| (vii) | Total Interest charged by the Bank for the year ending 31st March, 2016 | ₹ 1.6 crores |

You are required to show the treatment of Interest according to Accounting Standard by Zen Bridge Construction Limited.

(*MTP April, 2018*) (*5 Marks*)

**Answer:**

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use. As per the standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

The treatment of interest by Zen Bridge Construction Ltd. can be shown as:

| | Qualifying Asset | Interest to be Capitalized ₹ in crores | Interest to be charged to Profit & Loss A/c ₹ in crores | |
|---|---|---|---|---|
| Construction of hill road* | Yes | 1.25 | | 1.6/64 x 50 |
| Purchase of equipment and machineries | No | | 0.15 | 1.6/64x6 |
| Working capital | No | | 0.10 | 1.6/64x4 |
| Purchase of vehicles | No | | 0.025 | 1.6/64x1 |
| Advance for tools, cranes etc. | No | | 0.025 | 1.6/64x1 |
| Purchase of technical know-how | No | | 0.05 | 1.6/64x2 |
| Total | | 1.25 | 0.35 | |

*__Note__: It is assumed that construction of hill road will normally take more than a year (substantial period of time), hence considered as qualifying asset.

## Question 201

In May, 2018, Capacity Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2019 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2019 amounted to ₹ 25 lakhs.

Can ₹ 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

(*RTP November 2019*)

**Answer**

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2019) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

## Question 202

Govind Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.04.2018, to be utilized as under:

| *Particulars* | *Amount (₹ in lakhs)* |
|---|---|
| Construction of factory building | 40 |
| Purchase of Machinery | 35 |
| Working Capital | 25 |

In March 2019, construction of the factory building was completed and machinery was installed and ready for its intended use. Total interest on debentures for the financial year ended 31.03.2019 was ₹ 12,00,000. During the year 2018-19, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹ 3,00,000.

You are required to show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

[*RTP May 2020*]

**Answer**

According to AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= ₹ 12,00,000 – ₹ 3,00,000

= ₹ 9,00,000

| ***Sr. No.*** | ***Particulars*** | ***Nature of assets*** | ***Interest to be capitalized (₹)*** | ***Interest to be charged to Profit & Loss Account (₹)*** |
|---|---|---|---|---|
| (i) | Construction of factory building | Qualifying Asset | 9,00,000x40/100 = ₹ 3,60,000 | NIL |
| (ii) | Purchase of Machinery | Not a Qualifying Asset | NIL | 9,00,000x35/100 = ₹ 3,15,000 |
| (iii) | Working Capital | Not a Qualifying Asset | NIL | 9,00,000x25/100 = ₹ 2,25,000 |
| | Total | | ₹ 3,60,000 | ₹ 5,40,000 |

## Question 203

Vital Limited borrowed an amount of ₹150 crores on 1.4.2019 for construction of boiler plant @ 10% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Vital Ltd. capitalized ₹ 19.50 crores for the accounting period ending on 31.3.2020. Due to surplus fund out of ₹150 crores, an income of ₹ 1.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

[*RTP, November 2020*]

**Answer**

Para 10 of AS 16 'Borrowing Costs' states that to the extent the funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Vital Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2019-20 should be calculated as follows:

| | |
|---|---|
| Actual interest for 2019-20 (10% of ₹ 150 crores) | ₹ 15.00 crores |
| Less: Income on temporary investment from specific borrowings | (₹ 1.50 crores) |
| Borrowing costs to be capitalized during year 2019-2020 | ₹ 13.50 crores |

## Question 204

When capitalization of borrowing cost should cease as per Accounting Standard 16? Explain in brief.

[*RTP, November 2020*]

**Answer**

Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

## Question 205

A company incorporated in June 2020, has setup a factory within a period of 8 months with borrowed funds. The construction period of the assets had reduced drastically due to usage of technical innovations by the company and the company is able to justify the reasons for the same. Whether interest on borrowings for the period prior to the date of setting up the factory should be capitalized although it has taken less than 12 months for the assets to get ready for use. You are required to comment on the necessary treatment with reference to AS 16.

(*5 Marks*)

**Answer**

As per AS 16 'Borrowing Costs', a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Further, the standard states that what constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be jus tified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

It may be implied that there is a rebuttable presumption that a 12 months period constitutes substantial period of time.

Under present circumstances where construction period has reduced drastically due to technical innovation, the 12 months period should at best be looked at as a benchmark and not as a conclusive yardstick. It may so happen that an asset under normal circumstances may take more than 12 months to complete. However, an enterprise that completes the asset in 8 months should not be penalized for its efficiency by denying it interest capitalization and vice versa.

The substantial period criteria ensures that enterprises do not spend a lot of time and effort capturing immaterial interest cost for purposes of capitalization.

Therefore, if the factory is constructed in 8 months then it shall be considered as a qualifying asset. The interest on borrowings for the same shall be capitalised although it has taken less than 12 months for the asset to get ready to use.

## Question 206

When capitalisation of borrowing cost should cease as per Accounting Standard 16? Explain in brief.

**Answer**

Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalization of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

## Question 207

On 15th April, 2019 RBM Ltd. obtained a Term Loan from the Bank for ₹ 320 lakhs to be utilized as under:

| | ₹ (in lakhs) |
|---|---|
| Construction for factory shed | 240 |
| Purchase of Machinery | 30 |
| Working capital | 24 |
| Purchase of Vehicles | 12 |
| Advance for tools/cranes etc. | 8 |
| Purchase of technical know how | 6 |

In March, 2020 construction of shed was completed and machinery was installed. Total interest charged by the bank for the year ending 31st March, 2020 was ₹ 40 lakhs.

In the context of provisions of AS 16 'Borrowing Costs', show the treatment of interest and also explain the nature of Assets.

(5 Marks) (November 2020)

**Answer**

As per AS 16 A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Other investments and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred.

Construction of factory shed amounting ₹ 240 lakhs is qualifying asset in the given case. The interest for this amount during the year will be added to the cost of factory shed. All others (purchase of machinery, vehicles and technical know how, working capital, advance for tools/cranes) are non-qualifying assets and related borrowing cost will be charged to Profit and Loss statement.

Qualifying Asset as per AS 16 (construction of a shed) = ₹ 240 lakhs Borrowing cost to be capitalized = ₹ 40 lakhs x 240/320 = ₹ 30 lakhs Interest to be debited to Profit or Loss account: ₹ (40 – 30) = ₹ 10 lakhs.

Note: Assumed that construction of factory shed completed on 31st March, 2020.

## Question 208

When capitalisation of borrowing cost should cease as per Accounting Standard 16?

(*Study Material*)

**Answer**

Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

## Question 209

On 1st April, 20X1, Amazing Construction Ltd. obtained a loan of ₹ 32 crores to be utilised as under:

(i) Construction of sealink across two cities:
(work was held up totally for a month during the year due to high water levels) : ₹ 25crores

(ii) Purchase of equipments and machineries : ₹ 3 crores

| | | | |
|---|---|---|---|
| (iii) | Working capital | : | ₹ 2 crores |
| (iv) | Purchase of vehicles | : | ₹ 50,00,000 |
| (v) | Advance for tools/cranes etc. | : | ₹ 50,00,000 |
| (vi) | Purchase of technical know-how | : | ₹ 1 crores |
| (vii) | Total interest charged by the bank for the year ending 31st March, 20X2 | : | ₹ 80,00,000 |

Show the treatment of interest by Amazing Construction Ltd.

(*Study Material*)

**Answer**

According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use.

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

The treatment of interest by Amazing Construction Ltd. can be shown as:

| | ***Qualifying Asset*** | ***Interest to be capitalised ₹*** | ***Interest to be charged to Profit & Loss A/c ₹*** | |
|---|---|---|---|---|
| Construction of sea-link | Yes | 62,50,000 | | [80,00,000x(25/32)] |
| Purchase of equipments and machineries | No | | 7,50,000 | [80,00,000x(3/32)] |
| Working capital | No | | 5,00,000 | [80,00,000x(2/32)] |
| Purchase of vehicles | No | | 1,25,000 | [80,00,000x(0.5/32)] |
| Advance for tools, cranes etc. | No | | 1,25,000 | [80,00,000x(0.5/32)] |
| Purchase of technical know- how | No | | 2,50,000 | [80,00,000x(1/32)] |
| Total | | 62,50,000 | 17,50,000 | |

## Question 210

Suhana Ltd. issued 12% secured debentures of ₹100 Lakhs on 01.05.2018, to be utilized as under:

| **Particulars** | **Amount (₹ in lakhs)** |
|---|---|
| Construction of factory building | 40 |
| Purchase of Machinery | 35 |
| Working Capital | 25 |

In March 2019, construction of the factory building was completed and machinery was installed and ready for its intended use. Total interest on debentures for the financial year ended 31.03.2019 was ₹11,00,000. During the year 2018-19, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹2,00,000.

Show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

*[MTP October, 2019, 5 marks]*

**Answer**

According to AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost

= ₹ 11,00,000-₹ 2,00,000

= ₹ 9,00,000

| **Sr. No.** | **Particulars** | **Nature of assets** | **Interest to be Capitalized (₹)** | **Interest to be charged to Profit & Loss Account (₹)** |
|---|---|---|---|---|
| i | Construction of factory building | Qualifying Asset* | 9,00,000x40/100 = ₹3,60,000 | Nil |
| ii | Purchase of Machinery | Not a Qualifying Asset | Nil | 9,00,000x35/100 = ₹3,15,000 |
| iii | Working Capital | Not a Qualifying Asset | Nil | 9,00,000x25/100 = ₹2,25,000 |
| | Total | | ₹ 3,60,000 | ₹ 5,40,000 |

* A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

## Question 211

Omega Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2019-20 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment of loan exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2020 was ₹ 62 per US $. If Omega Limited had borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%.

You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2020 as per applicable Accounting Standards. (*4 Marks*)

**Answer**

(i) Interest for the period 2019-20
= US $ 10 lakhs x 4% × ₹ 62 per US$ = ₹ 24.80 lakhs

(ii) Increase in the liability towards the principal amount
= US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency
= US $ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11.

## Question 212

ABC Limited has started construction of an asset on 1st December, 2020, which continues till 31st March, 2021 (and is expected to go beyond a year). The entity has not taken any specific borrowings to finance the construction of the asset but has incurred finance costs on its general borrowings during the construction period. The directly attributable expenditure at the beginning of the month on this asset was ₹ 10 lakh in December 2020 and ₹ 4 lakh in each of the months of January to March 2021. At the beginning of the year, the entity had taken Inter Corporate Deposits of ₹ 20 lakh at 9% rate of interest and had an overdraft of ₹ 4 lakh, which increased to ₹ 8 lakh on 1st March, 2021. Interest was paid on the overdraft at 10% until 1st January, 2021 and then the rate was increased to 12%. You are required to calculate the annual capitalization rate for computation of borrowing cost in accordance with AS 16 'Borrowing Costs'.

(*MTP, November, 2021*) (*5 Marks*)

**Answer**

Calculation of capitalization rate on borrowings other than specific borrowings

| ***Nature of general borrowings*** | ***Period of outstanding balance*** | ***Amount of loan (₹)*** | ***Rate of interest p.a.*** | ***Weighted average amount of interest (₹)*** |
|---|---|---|---|---|
| | ***a*** | ***b*** | ***c*** | ***d = [(b x c) x (a/12)]*** |
| 9% Debentures | 12 months | 20,00,000 | 9% | 1,80,000 |
| Bank overdraft | 9 months | 4,00,000 | 10% | 30,000 |
| | 2 months | 4,00,000 | 12% | 8,000 |
| | 1 month | 8,00,000 | 12% | 8,000 |
| | | 36,00,000 | | 2,26,000 |

Weighted average cost of borrowings

= {20,00,000 x(12/12)} + {4,00,000 x (11/12)} + {8,00,000 x (1/12)} = 24,33,334

**Capitalisation rate** = [(Weighted average amount of interest/Weighted average of general borrowings) x 100] = [(2,26,000/24,33,334) x 100] = 9.29% p.a.

## Question 213

In May, 2020, Omega Ltd. took a bank loan from a Bank. This loan was to be used specifically for the construction of a new factory building. The construction was completed in January, 2021 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2021 amounted to ₹ 25 lakhs. The company wants to treat ₹ 25 lakhs as part of the cost of factory building and thus capitalize it on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

(*RTP, November 2021*)

**Answer**

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2021) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

## Question 214

(a) An enterprise has constructed a complex piece of equipment (qualifying asset) that is to be installed on the production line of a manufacturing plant. The equipment has been constructed over a period of 15 months. However, on installation, certain calibrations are required to achieve the desired level of production before it is finally commissioned. This process is expected to take approximately 2 months during which test runs will be made. Should the borrowing costs attributable to borrowings pertaining to the 2 months test run period be capitalized?

(b) Should capitalization of borrowing costs be continued when the qualifying asset has been constructed but marketing activities to sell the asset are still in progress?

*(RTP May, 2022)*

**Answer**

**(a)** As per AS 16 Borrowing Costs "Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete". On installation of the equipment, an evaluation has to be made to conclude whether substantially all the activities necessary to prepare the asset are complete. After an equipment has been installed it is usually tested and adjusted for commercial production before it is finally commissioned. The calibrations and adjustments required during this period are performed in order to bring the equipment up to the stage at which it is ready to commence commercial production. Until the asset reaches the stage when it is ready to support commercial levels of production, it is not appropriate to conclude that substantially all the activities necessary to prepare the asset are complete. Thus, the borrowing cost incurred during the normal period of test runs (after the installation) are required to be capitalized.

**(b)** As per provisions of AS 16, capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Further, the standard also explains that "An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might sill continue. If minor modifications, such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete". The emphasis in the Standard is on "to prepare the qualifying asset for its intended use or sale" and not the actual activity of sale. Therefore, where the physical construction of the asset is complete, substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Therefore, in the given case, the borrowing costs pertaining to the period during which the marketing activities to sell the asset are still in progress should not be capitalized as part of the cost of the asset.

# Test Your Knowledge
# MCQ

**1.** Which item of inventory is under the scope of AS 2 (Revised)?
- (a) WIP arising under construction contracts
- (b) Raw materials
- (c) Shares, Debentures held as stock in trade.

**Answer:** (b)

**2.** Crown Ltd. wants to prepare its cash flow statement. It sold equipment of book value of ₹ 60,000 at a gain of ₹ 8,000. The amount to be reported in its cash flow statement under operating activities is
- (a) Nil
- (b) ₹ 8,000
- (c) ₹ 68,000

**Answer:** (a)

**3.** While preparing cash flows statement, an entity (other than a financial institution) should disclose the dividends received from its investment in shares as
- (a) operating cash inflow
- (b) investing cash inflow
- (c) financing cash inflow

**Answer:** (b)

**4.** As per AS 10 (Revised) 'Property, plant and equipment', which of the following costs is not included in the carrying amount of an item of PPE
- (a) Costs of site preparation
- (b) Costs of relocating
- (c) Installation and assembly costs.

**Answer:** (b)

**5.** As per AS 10 (Revised) 'Property, Plant and Equipment', an enterprise holding investment properties should value Investment property

(a) as per fair value
(b) under discounted cash flow model.
(c) under cost model

**Answer:** (c)

**6.** As per AS 11 assets and liabilities of non-integral foreign operations should be converted at _ rate.
(a) Opening
(b) Average
(c) Closing

**Answer:** (c)

**7.** The debit or credit balance of “Foreign Currency Monetary Item Translation Difference Account”
(a) Is shown as “Miscellaneous Expenditure” in the Balance Sheet
(b) Is shown under “Reserves and Surplus” as a separate line item
(c) Is shown as “Other Non-current/Current Assets” in the Balance Sheet

**Answer:** (b)

**8.** If asset of an integral foreign operation is carried at cost, cost and depreciation of tangible fixed asset is translated at
(a) Average exchange rate
(b) Closing exchange rate
(c) Exchange rate at the date of purchase of asset

**Answer:** (c)

**9.** To encourage industrial promotion, IDCI offers subsidy worth ₹ 50 lakhs to all new industries set up in the specified industrial areas. This grant is in the nature of promoter’s contribution. How such subsidy should be accounted in the books?
(a) Credit it to capital reserve
(b) Credit it as ‘other income’ in the profit and loss account in the year of commencement of commercial operations
(c) Both (a) and (b) are permitted

**Answer:** (a)

**10.** As per AS 16, all of the following are qualifying assets except
(a) Manufacturing plants and Power generation facilities
(b) Inventories that require substantial period of time
(c) Assets those are ready for sale.

**Answer:** (c)

**11.** Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be
(a) sold above cost.
(b) sold less than cost.
(c) sold at or above cost.

**Answer:** (c)

**12.** All of the following costs are excluded while computing value of inventories except?
(a) Selling and Distribution costs
(b) Allocated fixed production overheads based on normal capacity.
(c) Abnormal wastage

**Answer:** (b)

**13.** If an investment is acquired in exchange for another asset, it will be valued at
(a) Fair value of the asset given up.
(b) Fair value of the investment acquired.
(c) Either (a) or (b), whichever is more clearly evident.

**Answer:** (c)

**14.** XYZ Co. is a financial enterprise. In its cash flow statement, interest paid and dividends received should be
(a) classified as operating cash flows.
(b) classified as financing cash flows.
(c) Not shown in cash flow statement.

**Answer:** (a)

**15.** Government grants that are receivable as compensation for expenses or losses incurred in a previous accounting period or for the purpose of giving immediate financial support to the enterprise with no further related costs, should be

(a) recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable as an ordinary item.

(b) recognised and disclosed in the Statement of Profit and Loss of the period in which the losses or expenses were incurred.

(c) recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable, as an extraordinary item if appropriate as per AS 5.

**Answer:** (c)

CHAPTER 4

# Cash Flow Statements

**Question 1**

*Intelligent Ltd., a non-financial company has the following entries in its Bank Account. It has sought your advice on the treatment of the same for preparing Cash Flow Statement.*

*(i) Loans and Advances given to the following and interest earned on them:*

*(1) to suppliers*

*(2) to employees*

*(3) to its subsidiaries companies*

*(ii) Investment made in subsidiary Smart Ltd. and dividend received*

*(iii) Dividend paid for the year*

*(iv) TDS on interest income earned on investments made*

*(v) TDS on interest earned on advance given to suppliers*

*(vi) Insurance claim received against loss of fixed asset by fire Discuss in the context of AS 3 Cash Flow Statement.*

(*Study Material*)

**Answer**

**(i) Loans and advances given and interest earned**

| | |
|---|---|
| (1) to suppliers | Operating Cash flow |
| (2) to employees | Operating Cash flow |
| (3) to its subsidiary companies | Investing Cash flow |

**(ii) Investment made in subsidiary company and dividend received**

Investing Cash flow

**(iii) Dividend paid for the year**

Financing Cash Outflow

**(iv) TDS on interest income earned on investments made**

Investing Cash Outflow

**(v) TDS on interest earned on advance given to suppliers**

Operating Cash Outflow

**(vi) Insurance claim received of amount loss of fixed asset by fire**

Extraordinary item to be shown under a separate heading as ‘Cash inflow from investing activities’.

## Question 2

*Following are extracts of the Balance Sheets of Ajay Ltd.:*

| | | Particulars | Notes | 31.3.20X1 ₹ | 31.3.20X2 ₹ |
|---|---|---|---|---|---|
| | | ***Equity and Liabilities*** | | | |
| | | ***Shareholder's funds*** | | | |
| | (*a*) | *Share capital* | *1* | *5,00,000* | *5,00,000* |
| | (*b*) | *Reserve & surplus* | *2* | *50,000* | *90,000* |
| | | ***Non-current liabilities*** | | | |
| | (*a*) | *Long-term borrowings* | *3* | *5,00,000* | *7,50,000* |
| | | ***Current liabilities*** | | | |
| | (*a*) | *Other current liabilities* | *4* | --- | *5,000* |
| | | ***Assets*** | | | |
| | | ***Non-current assets*** | | | |
| | (*a*) | *Intangible assets* | *5* | *2,05,000* | *1,80,000* |

***Notes to accounts***

| | | 31.3.20X1 ₹ | 31.3.20X2 ₹ |
|---|---|---|---|
| **1** | ***Share Capital*** | | |
| | *50,000 Equity Shares of ₹10 each* | *5,00,000* | *5,00,000* |
| **2** | ***Reserve & surplus*** | | |
| | *Profit & Loss A/c* | *50,000* | *90,000* |
| **3** | ***Long-term borrowings*** | | |
| | *10% Debentures* | *5,00,000* | *7,50,000* |
| **4** | ***Other current liabilities*** | | |
| | *Unpaid interest* | **---** | *5,000* |
| **5** | ***Intangible assets*** | | |
| | *Goodwill* | *2,05,000* | *1,80,000* |

*You are required to show the related items in Cash Flow Statement.*

(*Study Material*)

**Answer**

**An Extract of Cash Flow Statement for the year ending 31.3.20X2**

| | ₹ |
|---|---|
| ***Cash flows from operating activities:*** | |
| Closing balance as per Profit & Loss A/c | 90,000 |
| *Less*: Opening balance as per Profit & Loss Alc | (50,000) |
| *Add*: Goodwill amortisation | 25,000 |
| *Add*: Interest on Debentures (Refer Note 1) | 75,000 |
| Net Cash from Operating Activities | 1,40,000 |

Note 1: Interest has been computed on the closing balance of debentures as on 31.3.20X2 assuming that all the additions/ deletions were made, if any, at the beginning of the year.

***Cash flows from financing activities:***

| | |
|---|---|
| Proceeds from debentures (Refer Working Note) | 2,50,000 |
| Interest paid on Debentures [less unpaid] | (70,000) |
| Net Cash from Financing Activities | 1,80,000 |

**Working Note:**

**10% Debentures Account**

| ***Particulars*** | **₹** | ***Particular*** | **₹** |
|---|---|---|---|
| To Balance c/d | 7,50,000 | By Balance b/d | 5,00,000 |
| | | By Bank A/c (Bal. fig.) | 2,50,000 |
| | 7,50,000 | | 7,50,000 |

## Question 3

*From the following information, calculate cash flow from operating activities:*

***Summary of Cash Account***
***for the year ended March 31, 20X1***

| ***Particulars*** | **₹** | ***Particulars*** | **₹** |
|---|---|---|---|
| *To Balance b/d* | *1,00,000* | *By Cash Purchases* | *1,20,000* |
| *To Cash sales* | *1,40,000* | *By Trade payables* | *1,57,000* |
| *To Trade receivables* | *1,75,000* | *By Office & Selling Expenses* | *75,000* |
| *To Trade Commission* | *50,000* | *By Income Tax* | *30,000* |
| *To Sale of Investment* | *30,000* | *By Investment* | *25,000* |
| *To Loan from Bank* | *1,00,000* | *By Repayment of Loan* | *75,000* |
| *To Interest & Dividend* | *1,000* | *By Interest on loan* | *10,000* |
| | | *By Balance c/d* | *1,04,000* |
| | *5,96,000* | | *5,96,000* |

(*Study Material*)

**Answer**

***Cash Flow Statement of ……***
***for the year ended March 31, 20X1(Direct Method)***

| ***Particulars*** | **₹** | **₹** |
|---|---|---|
| ***Operating Activities:*** | | |
| Cash received from sale of goods | 1,40,000 | |
| Cash received from Trade receivables | 1,75,000 | |
| Trade Commission received | 50,000 | 3,65,000 |
| *Less*: Payment for Cash Purchases | 1,20,000 | |
| Payment to Trade payables | 1,57,000 | |
| Office and Selling Expenses | 75,000 | |
| Payment for Income Tax | 30,000 | (3,82,000) |
| Net Cash Flow used in Operating Activities | | (17,000) |

## Question 4

*The following summary cash account has been extracted from the company's accounting records:*

**Summary Cash Account**

| | | **(₹ '000)** |
|---|---|---|
| *Balance at 1.3.20X1* | | *35* |
| *Receipts from customers* | | *2,783* |
| *Issue of shares* | | *300* |
| *Sale of fixed assets* | | *128* |
| *Payments to suppliers* | *2,047* | *3,246* |

| | | **(₹ ’000)** |
|---|---|---|
| *Payments for property, plant & equipment* | *230* | |
| *Payments for overheads* | *115* | |
| *Wages and salaries* | *69* | |
| *Taxation* | *243* | |
| *Dividends* | *80* | *(3,034)* |
| *Repayments of bank loan* | *250* | |
| *Balance at 31.3.20X2* | | *212* |

*Prepare Cash Flow Statement of this company Hills Ltd. for the year ended 31st March, 20X2 in accordance with AS-3 (Revised).*

*The company does not have any cash equivalents.*

(*Study Material*)

**Answer**

**Hills Ltd.**

**Cash Flow Statement for the year ended 31st March, 20X2 (Using direct method)**

| | | **(₹’000)** |
|---|---|---|
| **Cash flows from operating activities** | | |
| Cash receipts from customers | 2,783 | |
| Cash payments to suppliers | (2,047) | |
| Cash paid to employees | (69) | |
| Other cash payments (for overheads) | (115) | |
| Cash generated from operations | 552 | |
| Income taxes paid | (243) | |
| *Net cash from operating activities* | | 309 |
| **Cash flows from investing activities** | | |
| Payments for purchase of fixed assets | (230) | |
| Proceeds from sale of fixed assets | 128 | |
| *Net cash used in investing activities* | | (102) |
| **Cash flows from financing activities** | | |
| Proceeds from issuance of share capital | 300 | |
| Bank loan repaid | (250) | |
| Dividend paid | (80) | |
| *Net cash used in financing activities* | | (30) |
| **Net increase in cash and cash equivalents** | | 177 |
| **Cash and cash equivalents at beginning of period** | | 35 |
| **Cash and cash equivalents at end of period** | | 212 |

## Question 5

*Prepare cash flow statement of M/s MNT Ltd. for the year ended 31st March, 20X1 with the help of the following information:*

(1) *Company sold goods for cash only.*

(2) *Gross Profit Ratio was 30% for the year, gross profit amounts to ₹ 3,82,500.*

(3) *Opening inventory was lesser than closing inventory by ₹ 35,000.*

(4) *Wages paid during the year ₹ 4,92,500.*

(5) *Office and selling expenses paid during the year ₹ 75,000.*

(6) *Dividend paid during the year ₹ 30,000.*

(7) *Bank loan repaid during the year ₹ 2,15,000 (included interest ₹ 15,000).*

(8) *Trade payables on 31st March, 20X0 exceed the balance on 31st March, 20X1 by ₹ 25,000.*

(9) *Amount paid to trade payables during the year ₹ 4,60,000.*

(10) *Tax paid during the year amounts to ₹ 65,000 (Provision for taxation as on 31.03.20X1 ₹ 45,000).*

(11) *Investments of ₹ 7,00,000 sold during the year at a profit of ₹ 20,000.*

(12) *Depreciation on fixed assets amounts to ₹ 85,000.*

(13) *Plant and machinery purchased on 15th November, 20X0 for ₹ 2,50,000.*

(14) *Cash and Cash Equivalents on 31st March, 20X0 ₹ 2,00,000.*

(15) *Cash and Cash Equivalents on 31st March, 20X1 ₹ 6,07,500.*

(*Study Material*)

**Answer**

**M/s MNT Ltd.**

**Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)**

| ***Particulars*** | **₹** | **₹** |
|---|---|---|
| ***Cash flows from Operating Activities*** | | |
| Cash sales (₹ 3,82,500/.30) | | 12,75,000 |
| *Less:* Cash payments for trade payables | (4,60,000) | |
| Wages Paid | (4,92,500) | |
| Office and selling expenses | (75,000) | (10,27,500) |
| Cash generated from operations before taxes | | 2,47,500 |
| Income tax paid | | (65,000) |
| Net cash generated from operating activities (A) | | 1,82,500 |
| ***Cash flows from investing activities*** | | |
| Sale of investments (7,00,000 + 20,000) | 7,20,000 | |
| Payments for purchase of Plant & machinery | (2,50,000) | |
| Net cash used in investing activities (B) | | 4,70,000 |
| ***Cash flows from financing activities*** | | |
| Bank loan repayment (including interest) | (2,15,000) | |
| Dividend paid | (30,000) | |
| Net cash used in financing activities (C) | | (2,45,000) |
| Net increase in cash (A+B+C) | | 4,07,500 |
| **Cash and cash equivalents at beginning of the period** | | 2,00,000 |
| **Cash and cash equivalents at end of the period** | | 6,07,500 |

## Question 6

*Ryan Ltd provides you the following information at the year-end, March 31, 20X1:*

| | ₹ | ₹ |
|---|---|---|
| *Sales* | | *6,98,000* |
| *Cost of Goods Sold* | | *(5,20,000)* |
| *Operating Expenses* | | *1,78,000* |
| *(including Depreciation Expense of ₹ 37,000)* | | *(1,47,000)* |
| | | *31,000* |

| | ₹ | ₹ |
|---|---|---|
| *Other Income / (Expenses):* | | |
| *Interest Expense paid* | *(23,000)* | |
| *Interest Income received* | *6,000* | |
| *Gain on Sale of Investments* | *12,000* | |
| *Loss on Sale of Plant* | *(3,000)* | |
| | | *(8,000)* |
| | | *23,000* |
| *Income tax* | | *(7,000)* |
| | | *16,000* |

*Information available:*

| | **31st March 20X1** | **31st March 20X0** |
|---|---|---|
| | ₹ | ₹ |
| *Plant* | *7,15,000* | *5,05,000* |
| *Less: Accumulated Depreciation* | *(1,03,000)* | *(68,000)* |
| | *6,12,000* | *4,37,000* |
| *Investments (Long term)* | *1,15,000* | *1,27,000* |
| *Inventory* | *1,44,000* | *1,10,000* |
| *Trade receivables* | *47,000* | *55,000* |
| *Cash* | *46,000* | *15,000* |
| *Prepaid expenses* | *1,000* | *5,000* |
| *Share Capital* | *4,65,000* | *3,15,000* |
| *Reserves and surplus* | *1,40,000* | *1,32,000* |
| *Bonds* | *2,95,000* | *2,45,000* |
| *Trade payables* | *50,000* | *43,000* |
| *Outstanding liabilities* | *12,000* | *9,000* |
| *Income taxes payable* | *3,000* | *5,000* |

***Analysis of selected accounts and transactions during 20X0 -X1***

1. *Purchased investments for ₹ 78,000.*
2. *Sold investments for ₹ 1,02,000. These investments cost ₹ 90,000.*
3. *Purchased plant assets for ₹ 1,20,000.*
4. *Sold plant assets that cost ₹10,000 with accumulated depreciation of ₹ 2,000 for ₹ 5,000.*
5. *Issued ₹ 1,00,000 of bonds at face value in an exchange for plant assets on 31st March, 20X1.*
6. *Repaid ₹ 50,000 of bonds at face value at maturity.*
7. *Issued 15,000 shares of ₹ 10 each.*
8. *Paid cash dividends ₹ 8,000.*

*Prepare Cash Flow Statement as per AS-3 (Revised), using indirect method.*

(*Study Material*)

**Answer**

**Ryan Ltd.**
**Cash Flow Statement**
**for the year ending 31st March, 20X1**

| | ₹ | ₹ |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net profit before taxation | 23,000 | |
| Adjustments for: | | |
| Depreciation | 37,000 | |
| Gain on sale of investments | (12,000) | |
| Loss on sale of plant assets | 3,000 | |
| Interest expense | 23,000 | |
| Interest income | (6,000) | |
| Operating profit before working capital changes | 68,000 | |
| Decrease in trade receivables | 8,000 | |
| Increase in inventory | (34,000) | |
| Decrease in prepaid expenses | 4,000 | |
| Increase in trade payables | 7,000 | |
| Increase in outstanding liabilities | 3,000 | |
| Cash generated from operations | 56,000 | |
| Income taxes paid* | (9,000) | |
| *Net cash generated from operating activities* | | 47,000 |
| **Cash flows from investing activities** | | |
| Purchase of plant | (1,20,000) | |
| Sale of plant | 5,000 | |
| Purchase of investments | (78,000) | |
| Sale of investments | 1,02,000 | |
| Interest received | 6,000 | |
| *Net cash used in investing activities* | | (85,000) |
| **Cash flows from financing activities** | | |
| Proceeds from issuance of share capital | 1,50,000 | |
| Repayment of bonds | (50,000) | |
| Interest paid | (23,000) | |
| Dividends paid | (8,000) | |
| *Net cash from financing activities* | | 69,000 |
| **Net increase in cash and cash equivalents** | | 31,000 |
| **Cash and cash equivalents at the beginning of the period** | | 15,000 |
| **Cash and cash equivalents at the end of the period** | | 46,000 |

*__Working Note:__

| | ₹ |
|---|---:|
| Income taxes paid: | |
| Income tax expense for the year | 7,000 |
| *Add:* Income tax liability at the beginning of the year | 5,000 |
| | 12,000 |
| *Less:* Income tax liability at the end of the year | (3,000) |
| | 9,000 |

## Question 7

*The balance sheets of Sun Ltd. as at 31st March 20X1 and 20X0 were as:*

| | | Particulars | Notes | 20X1 ₹ | 20X0 ₹ |
|---|---|---|---|---:|---:|
| | | ***Equity and Liabilities*** | | | |
| **1** | | ***Shareholder's funds*** | | | |
| | (a) | *Share capital* | 1 | 60,000 | 50,000 |
| | (b) | *Reserve & surplus* | 2 | 5,000 | 4,000 |
| **2** | | ***Current liabilities*** | | | |
| | (a) | *Trade Payables* | | 4,000 | 2,500 |
| | (b) | *Other current liabilities* | 3 | - | 1,000 |
| | (c) | *Short term provision (provision for tax)* | | 1,500 | 1,000 |
| | | ***Total*** | | **70,500** | **58,500** |
| | | ***Assets*** | | | |
| **1** | | ***Non-current assets*** | | | |
| | (a) | *Property, Plant & Equipment* | 4 | 39,500 | 29,000 |
| **2** | | ***Current assets*** | | | |
| | (a) | *Current investments* | | 2,000 | 1,000 |
| | (b) | *Inventories* | | 17,000 | 14,000 |
| | (c) | *Trade receivables* | | 8,000 | 6,000 |
| | (d) | *Cash & cash equivalents* | 5 | 4,000 | 8,500 |
| | | | | **70,500** | **58,500** |

***Notes to accounts***

| | | 20X1 ₹ | 20X0 ₹ |
|---|---|---:|---:|
| 1 | ***Share Capital*** | | |
| | *Equity Shares of ₹10 each* | 60,000 | 50,000 |
| 2 | ***Reserve & surplus*** | | |
| | *Profit and Loss Account* | 5,000 | 4,000 |
| 3 | ***Other current liabilities*** | | |
| | *Dividend Payable* | - | 1,000 |
| 4 | ***Property, plant and equipment (at WDV)*** | | |
| | *Building* | 10,000 | 10,000 |
| | *Fixtures* | 17,000 | 11,000 |

| | | 20X1 ₹ | 20X0 ₹ |
|---|---|---|---|
| | *Vehicles* | 12,500 | 8,000 |
| | *Total* | 39,500 | 29,000 |
| 5 | ***Cash and cash equivalents*** | | |
| | *Cash and Bank* | 4,000 | 8,500 |

*The profit and loss statement for the year ended 31st March, 20X1 disclosed:*

| ***Particulars*** | ₹ |
|---|---|
| *Profit before tax* | 4,500 |
| *Tax expense: Current tax* | (1,500) |
| *Profit for the year* | 3,000 |
| *Declared dividend* | (2,000) |
| *Retained Profit* | 1,000 |

*Further information is available:*

| | ***Fixtures*** ₹ | ***Vehicles*** ₹ |
|---|---|---|
| *Depreciation for the year* | 1,000 | 2,500 |
| *Disposals:* | | |
| *Proceeds on disposal of vehicles* | — | 1,700 |
| *Written down value* | — | (1,000) |
| *Profit on disposal* | | 700 |

*Prepare a Cash Flow Statement for the year ended 31st March, 20X1.*

(*Study Material*)

**Answer**

**Sun Ltd.**
**Cash Flow Statement**
**for the year ended 31st March, 20X1**

| | ₹ | ₹ |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net Profit before taxation | 4,500 | |
| Adjustments for: | | |
| Depreciation | 3,500 | |
| Profit on sale of vehicles (1,700 – 1,000) | (700) | |
| Operating profit before working capital changes | 7,300 | |
| Increase in Trade receivables | (2,000) | |
| Increase in inventories | (3,000) | |
| Increase in Trade payables | 1,500 | |
| Cash generated from operations | 3,800 | |
| Income taxes paid (**W.N.1**) | (1,000) | |
| *Net cash generated from operating activities* | | 2,800 |
| **Cash flows from investing activities** | | |
| Sale of vehicles | 1,700 | |
| Purchase of current investments | (1,000) | |

| | ₹ | ₹ |
|---|---:|---:|
| Purchase of vehicles (**W.N.3**) | (8,000) | |
| Purchase of fixtures (**W.N.3**) | (7,000) | |
| *Net cash used in investing activities* | | (14,300) |
| **Cash flows from financing activities** | | |
| Issue of shares for cash | 10,000 | |
| Dividends paid **(W.N.2)** | (3,000) | |
| *Net cash generated from financing activities* | | 7,000 |
| **Net decrease in cash and cash equivalents** | | (4,500) |
| **Cash and cash equivalents at beginning of period (See Note)** | | 8,500 |
| **Cash and cash equivalents at end of period (See Note)** | | 4,000 |
| **Note to the Cash Flow Statement** | | |
| ***Cash and Cash Equivalents*** | *31.3.20X1* | *31.3.20X0* |
| Bank and Cash | 4,000 | 8,500 |
| Cash and cash equivalents | 4,000 | 8,500 |

**Working Notes:**

| | | | ₹ |
|---|---|---:|---:|
| 1. | **Income taxes paid** | | |
| | Income tax expense for the year | | 1,500 |
| | *Add:* Income tax liability at the beginning of the year | | 1,000 |
| | | | 2,500 |
| | *Less:* Income tax liability at the end of the year | | (1,500) |
| | | | 1,000 |
| 2. | **Dividend paid** | | |
| | Declared dividend for the year | | 2,000 |
| | *Add:* Amount payable at the beginning of the year | | 1,000 |
| | | | 3,000 |
| | *Less:* Amount payable at the end of the year | | - |
| | | | 3,000 |
| 3. | **Property, plant and equipment acquisitions** | | |
| | | *Fixtures* | *Vehicles* |
| | | ₹ | ₹ |
| | W.D.V. at 31.3.20X1 | 17,000 | 12,500 |
| | *Add back:* | | |
| | Depreciation for the year | 1,000 | 2,500 |
| | Disposals | — | 1,000 |
| | | 18,000 | 16,000 |
| | *Less:* W.D.V. at 31.12.20X0 | (11,000) | (8,000) |
| | Acquisitions during 20X0-20X1 | 7,000 | 8,000 |

**Note**: Current investments may not be readily convertible to a known amount of cash and may not be subject to an insignificant risk of changes in value as per the requirements of AS 3 and hence those have been considered as investing activities.

## Question 8

*Ms. Jyoti of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year ended 31st March, 20X1:*

| | **(₹ *in lakhs*)** |
|---|---:|
| *Net Profit* | *25,000* |
| *Dividend paid* | *8,535* |
| *Provision for Income tax* | *5,000* |
| *Income tax paid during the year* | *4,248* |
| *Loss on sale of assets (net)* | *40* |
| *Book value of the assets sold* | *185* |
| *Depreciation charged to the Statement of Profit and Loss* | *20,000* |
| *Profit on sale of Investments* | *100* |
| *Carrying amount of Investment sold* | *27,765* |
| *Interest income received on investments* | *2,506* |
| *Interest expenses of the year* | *10,000* |
| *Interest paid during the year* | *10,520* |
| *Increase in Working Capital (excluding Cash & Bank Balance)* | *56,081* |
| *Purchase of Fixed assets* | *14,560* |
| *Investment in joint venture* | *3,850* |
| *Expenditure on construction work in progress* | *34,740* |
| *Proceeds from calls in arrear* | *2* |
| *Receipt of grant for capital projects* | *12* |
| *Proceeds from long-term borrowings* | *25,980* |
| *Proceeds from short-term borrowings* | *20,575* |
| *Opening cash and bank balance* | *5,003* |
| *Closing cash and bank balance* | *6,988* |

*Prepare the Cash Flow Statement for the year ended 31 March 20X1 in accordance with AS 3.* (*Make necessary assumptions*)

(*Study Material*)

**Answer**

**Star Oils Limited Cash Flow Statement**
**for the year ended 31st March, 20X1**

| | | **(₹ *in lakhs*)** |
|---|---:|---:|
| **Cash flows from operating activities** | | |
| Net profit before taxation (25,000 + 5,000) | 30,000 | |
| Adjustments for : | | |
| Depreciation | 20,000 | |
| Loss on sale of assets (Net) | 40 | |
| Profit on sale of investments | (100) | |
| Interest income on investments | (2,506) | |
| Interest expenses | 10,000 | |
| Operating profit before working capital changes | 57,434 | |
| Changes in working capital (Excluding cash and bank balance) | (56,081) | |
| Cash generated from operations | 1,353 | |

| | | **(₹ *in lakhs*)** |
|---|---|---|
| Income taxes paid | (4,248) | |
| Net cash used in operating activities | | (2,895) |
| **Cash flows from investing activities** | | |
| Sale of assets (W.N.1) | 145 | |
| Sale of investments (27,765 + 100) | 27,865 | |
| Receipt of grant for capital projects Interest income on investments | 12<br>2,506 | |
| Purchase of fixed assets | (14,560) | |
| Investment in joint venture | (3,850) | |
| Expenditure on construction work-in progress | (34,740) | |
| Net cash used in investing activities | | (22,622) |
| **Cash flows from financing activities** | | |
| Proceeds from calls in arrear | 2 | |
| Proceeds from long-term borrowings | 25,980 | |
| Proceed from short-term borrowings | 20,575 | |
| Interest paid | (10,520) | |
| Dividend (including dividend tax) paid | (8,535) | 27,502 |
| Net increase in cash and cash equivalents | | 1,985 |
| Cash and cash equivalents at the beginning of the period | | 5,003 |
| Cash and cash equivalents at the end of the period | | 6,988 |

**Working note:**

| | |
|---|---|
| **1.** Book value of the assets sold | 185 |
| *Less:* Loss on sale of assets | (40) |
| Proceeds on sale | 145 |

## Question 9

*From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 20X1 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.*

***Summary Cash Account for the year ended 31 3.20X1***

| | **₹000** | | **₹000** |
|---|---|---|---|
| *Balance on 1.4.20X0* | *50* | *Payment to Suppliers* | *2,000* |
| *Issue of Equity Shares* | *300* | *Purchase of Fixed Asset* | *200* |
| *Receipts from Customers* | *2,800* | *Overhead expense* | *200* |
| *Sale of Fixed Assets* | *100* | *Wages and Salaries* | *100* |
| | | *Taxation* | *250* |
| | | *Dividend* | *50* |
| | | *Repayment of Bank Loan* | *300* |
| | | *Balance on 31.3.20X1* | *150* |
| | *3,250* | | *3,250* |

(*Study Material*)

**Answer**

**X Ltd.**

**Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)**

| | *₹ '000* | *₹ '000* |
|---|---|---|
| **Cash flows from operating activities** | | |
| Cash receipts from customers | 2,800 | |
| Cash payments to suppliers | (2,000) | |
| Cash paid to employees | (100) | |
| Cash payments for overheads | (200) | |
| Cash generated from operations | 500 | |
| Income tax paid | (250) | |
| *Net cash generated from operating activities* | | 250 |
| **Cash flows from investing activities** | | |
| Payments for purchase of fixed assets | (200) | |
| Proceeds from sale of fixed assets | 100 | |
| *Net cash used in investing activities* | | (100) |
| **Cash flows from financing activities** | | |
| Proceeds from issuance of equity shares | 300 | |
| Bank loan repaid | (300) | |
| Dividend paid | (50) | |
| *Net cash used in financing activities* | | (50) |
| Net increase in cash | | 100 |
| Cash at the beginning of the year | | 50 |
| Cash at the end of the year | | 150 |

**Question 10**

*Given below are the relevant extracts of the Balance Sheet and the Statement of Profit and Loss of ABC Ltd. along with additional information:*

**Extract of Balance sheet**

| | | Particulars | Notes | 31.3.20X1 (₹ in lakhs) | 31.3.20X0 (₹ in lakhs) |
|---|---|---|---|---|---|
| | | ***Equity and Liabilities*** | | | |
| ***1*** | | ***Current liabilities*** | | | |
| | (a) | *Trade Payables* | | *250* | *230* |
| | (b) | *Short term Provisions* | *1* | *200* | *180* |
| | (c) | *Other current liabilities* | *2* | *70* | *50* |
| | | ***Assets*** | | | |
| ***1*** | | ***Current assets*** | | | |
| | (a) | *Inventories* | | *200* | *180* |
| | (b) | *Trade Receivables* | | *400* | *250* |
| | (c) | *Other current assets* | *3* | *195* | *180* |

***Statement of Profit and Loss of ABC Ltd. for the year ended 31st March, 20X1***

| | ***Particulars*** | ***Notes*** | ***₹ in lakhs*** |
|---|---|---|---|
| ***I*** | *Revenue from operations* | | *4,150* |
| ***II*** | *Other income* | *4* | *100* |
| ***III*** | *Total Revenue (I + II)* | | ***4,250*** |
| | ***Expenses**:* | | |
| | *Purchases of Stock-in-Trade* | | *2,400* |
| | *Change in inventories of finished goods* | | *(20)* |
| | *Employee benefits expense* | | *800* |
| | *Depreciation expense* | | *100* |
| ***IV*** | *Finance cost* | *5* | *60* |
| | *Other expenses* | | *200* |
| | ***Total expenses*** | | ***3,540*** |
| ***V*** | *Profit before tax (**III – IV**)* | | *710* |
| ***VI*** | *Tax expense:* | | |
| | *Current tax* | | *200* |
| ***VII*** | *Profit for the year from continuing operations* | | *510* |

***Appropriations***

| | |
|---|---|
| *Balance of Profit and Loss account brought forward* | *50* |
| *Transfer to general reserve* | *200* |
| *Dividend paid* | *330* |

**Notes to accounts:**

| | | ***20X1 (₹ in lakhs)*** | ***20X0 (₹ in lakhs)*** |
|---|---|---|---|
| *1* | *Short term Provisions:* | | |
| | *Provision for Tax* | *200* | *180* |
| *2* | *Other current liabilities:* | | |
| | *Outstanding wages* | *50* | *40* |
| | *Outstanding expenses* | *20* | *10* |
| | *Total* | *70* | *50* |
| *3* | *Other current assets:* | | |
| | *Advance tax* | *195* | *180* |
| *4* | *Other income:* | | |
| | *Interest and dividend* | *100* | |
| *5* | *Finance cost:* | | |
| | *Interest* | *60* | |

*Compute cash flow from operating activities using both direct and indirect method.*

(*Study Material*)

**Answer**

**Cash Flows from Operating Activities**

| | ***₹ in lakhs*** | ***₹ in lakhs*** |
|---|---|---|
| **Using Direct Method Cash Receipts:** | | |
| Cash sales and collection from Trade receivables | | |
| Sales + Opening Trade receivables – Closing Trade receivables (A) | 4,150 + 250 - 400 | 4,000 |

| | ₹ in lakhs | | ₹ in lakhs |
|---|---|---|---|
| Cash payments: | | | |
| Cash purchases & payment to Trade payables | | | |
| Purchases + Opening Trade payables – Closing Trade payables | 2,400 + 230 - 250 | | 2,380 |
| Wages and salaries paid | 800 + 40 - 50 | | 790 |
| Cash expenses | 200 + 10 - 20 | | 190 |
| Taxes paid – Advance tax | | | 195 |
| (B) | | | 3,555 |
| Cash flow from operating activities (A – B) | | | 445 |
| **Using Indirect Method** | | | |
| Profit before tax | | | 710 |
| *Add:* Non-cash items : Depreciation | | | 100 |
| *Add:* Interest : Financing cash inflow | | | 60 |
| *Less:* Interest and Dividend : Investment cash outflow | | | (100) |
| *Less:* Tax paid | | | (195) |
| Working capital adjustments | | | |
| Trade receivables | 250 - 400 | (150) | |
| Inventories | 180 - 200 | (20) | |
| Trade payables | 250 - 230 | 20 | |
| Outstanding wages | 50 - 40 | 10 | |
| Outstanding expenses | 20- 10 | 10 | (130) |
| Cash flow from operating activities | | | 445 |

## Question 11

*Prepare Cash flow for Gamma Ltd., for the year ending 31.3.20X1 from the following information:*

*(1) Sales for the year amounted to ₹ 135 crores out of which 60% was cash sales.*

*(2) Purchases for the year amounted to ₹ 55 crores out of which credit purchase was 80%.*

*(3) Administrative and selling expenses amounted to ₹ 18 crores and salary paid amounted to ₹ 22 crores.*

*(4) The Company redeemed debentures of ₹ 20 crores at a premium of 10%. Debenture holders were issued equity shares of ₹ 15 crores towards redemption and the balance was paid in cash. Debenture interest paid during the year was ₹ 1.5 crores.*

*(5) Dividend paid during the year amounted to ₹ 11.7 crores.*

*(6) Investment costing ₹ 12 crores were sold at a profit of ₹ 2.4 crores.*

*(7) ₹ 8 crores was paid towards income tax during the year.*

*(8) A new plant costing ₹ 21 crores was purchased in part exchange of an old plant. The book value of the old plant was ₹ 12 crores but the vendor took over the old plant at a value of ₹ 10 crores only. The balance was paid in cash to the vendor.*

*(9) The following balances are also provided:*

| | ₹ in crores 1.4.20X0 | ₹ in crores 31.3.20X1 |
|---|---|---|
| *Debtors* | *45* | *50* |
| *Creditors* | *21* | *23* |
| *Bank* | *6* | *18.2* |

(*Study Material*)

**Answer**

**Gamma Ltd.**

**Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)**

| ***Particulars*** | ***₹ in crores*** | ***₹ in crores*** |
|---|---|---|
| Cash flows from operating activities | | |
| Cash sales (60% of 135) | 81 | |
| Cash receipts from Debtors | 49 | |
| [45+ (135x40%) - 50] | | |
| Cash purchases (20% of 55) | (11) | |
| Cash payments to suppliers | (42) | |
| [21+ (55x80%) – 23] | | |
| Cash paid to employees | (22) | |
| Cash payments for overheads (Adm. and selling) | (18) | |
| Cash generated from operations | 37 | |
| Income tax paid | (8) | |
| Net cash generated from operating activities | | 29 |
| Cash flows from investing activities | | |
| Sale of investments (12+ 2.40) | 14.4 | |
| Payments for purchase of fixed assets (21 – 10) | (11) | |
| Net cash generated from investing activities | | 3.4 |
| Cash flows from financing activities | | |
| Redemption of debentures (22-15) | (7) | |
| Interest paid | (1.5) | |
| Dividend paid | (11.7) | |
| Net cash used in financing activities | | (20.2) |
| Net increase in cash | | 12.2 |
| Cash at beginning of the period | | 6.0 |
| Cash at end of the period | | 18.2 |

## Question 12

*From the following information of Mr. Zen, prepare a Cash flow statement as per AS- 3 for the year ended 31.3.20X1:*

***Ledger balances of Mr. Zen as of 20X0 and 20X1***

| | ***As on 1.4.20X0*** | ***As on 1.4.20X1*** |
|---|---|---|
| | ***₹*** | ***₹*** |
| *Zen's Capital A/c* | *10,00,000* | *12,24,000* |
| *Trade payables* | *3,20,000* | *3,52,000* |
| *Mrs. Zen's loan* | *2,00,000* | *--* |
| *Loan from Bank* | *3,20,000* | *4,00,000* |
| *Land* | *6,00,000* | *8,80,000* |
| *Plant and Machinery* | *6,40,000* | *4,40,000* |
| *Inventories* | *2,80,000* | *2,00,000* |
| *Trade receivables* | *2,40,000* | *4,00,000* |
| *Cash* | *80,000* | *56,000* |

**Additional information:**

*A machine costing ₹ 80,000 (accumulated depreciation there on ₹24,000) was sold for ₹ 40,000. The provision for depreciation on 1.4.20X0 was ₹ 2,00,000 and 31.3.20X1 was ₹ 3,20,000. The net profit for the year ended on 31.3.20X1 was ₹ 3,60,000.*

(*Study Material*)

**Answer**

**Cash Flow Statement of Mr. Zen as per AS 3 for the year ended 31.3.20X1**

| | | ₹ |
|---|---|---|
| **(i) Cash flow from operating activities** | | |
| Net Profit (given) | | 3,60,000 |
| ***Adjustments for*** | | |
| Depreciation on Plant & Machinery (W.N.2) | 1,44,000 | |
| Loss on Sale of Machinery (W.N.1) | 16,000 | 1,60,000 |
| Operating Profit before working capital changes | | 5,20,000 |
| Decrease in inventories | 80,000 | |
| Increase in trade receivables | (1,60,000) | |
| Increase in trade payables | 32,000 | (48,000) |
| ***Net cash generated from operating activities*** | | 4,72,000 |
| **(ii) Cash *flow from* investing activities** | | |
| Sale of Machinery (W.N.1) | 40,000 | |
| Purchase of Land (8,80,000 – 6,00,000) | (2,80,000) | |
| ***Net cash used in investing activities*** | | (2,40,000) |
| **(iii) Cash *flow from* financing activities** | | |
| Repayment of Mrs. Zen's Loan | (2,00,000) | |
| Drawings (W.N.3) | (1,36,000) | |
| Loan from Bank | 80,000 | |
| ***Net cash used in financing activities*** | | (2,56,000) |
| Net decrease in cash | | (24,000) |
| Opening balance as on 1.4.20X0 | | 80,000 |
| Cash balance as on 31.3.20X1 | | 56,000 |

**Working Notes:**

**1. Plant & Machinery A/c**

| | ₹ | | ₹ |
|---|---|---|---|
| To Balance b/d (6,40,000 + 2,00,000) | 8,40,000 | By Cash – Sales | 40,000 |
| | | By Provision for Depreciation A/c | 24,000 |
| | | By Profit & Loss A/c – Loss on Sale (80,000 – 64,000) | 16,000 |
| | | By Balance c/d (4,40,000+3,20,000) | 7,60,000 |
| | 8,40,000 | | 8,40,000 |

**2. Provision for depreciation on Plant and Machinery A/c**

| | ₹ | | ₹ |
|---|---|---|---|
| To Plant and Machinery A/c | 24,000 | By Balance b/d | 2,00,000 |
| To Balance c/d | 3,20,000 | By Profit & Loss A/c (Bal. fig.) | 1,44,000 |
| | 3,44,000 | | 3,44,000 |

**3. To find out Mr. Zen's drawings:**

| | ₹ |
|---|---|
| Opening Capital | 10,00,000 |
| *Add:* Net Profit | 3,60,000 |
| | 13,60,000 |
| *Less*: Closing Capital | (12,24,000) |
| Drawings | 1,36,000 |

**Note**: Students may note that in case there is an increase in the amount of debentures/ loans during the year and the interest is required to be computed, then in such a case, students may choose either to compute interest on the closing balance of the debentures or may compute interest on opening balance for full year (in case of no repayment) and proportionate interest on additions. Suitable note for assumption may be given in the solution for this.

# Theoretical Questions

## Question 13

What is the significance of cash flow statement? Explain in brief.

(*Study Material*)

**Answer**

Cash flow statement provides information about the changes in cash and cash equivalents of an enterprise. It identifies cash generated from trading operations and is very useful tool of planning.

## Question 14

Explain the difference between direct and indirect methods of reporting cash flows from operating activities with reference to AS 3.

(*Study Material*)

**Answer**

As per Para 18 of AS 3 (Revised) on Cash Flow Statements, an enterprise should report cash flows from operating activities using either:

(a) The direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

# Practical Questions

## Question 15

Classify the following activities as (a) Operating activities, (b) Investing activities (c) Financing activities (d) Cash equivalents with reference to AS 3 (Revised).

(a) Brokerage paid on purchase of investments

(b) Underwriting commission paid

(c) Trading commission received

(d) Proceeds from sale of investment
(e) Purchase of goodwill
(f) Redemption of preference shares
(g) Rent received from property held as investment
(h) Interest paid on long-term borrowings
(i) Marketable securities (having risk of change in value)
(j) Refund of income tax received

(*Study Material*)

**Answer**

**Classification of activities with reference to AS 3**

| | | |
|---|---|---|
| (a) | Brokerage paid on purchased of investments | Investing Activities |
| (b) | Underwriting Commission paid | Financing Activities |
| (c) | Trading Commission received | Operating Activities |
| (d) | Proceeds from sale of investment | Investing Activities |
| (e) | Purchase of goodwill | Investing Activities |
| (f) | Redemption of Preference shares | Financing Activities |
| (g) | Rent received from property held as investment | Investing Activities |
| (h) | Interest paid on long term borrowings | Financing Activities |
| (i) | Marketable securities | Not a Cash equivalent |
| (j) | Refund of Income tax received | Operating activities |

## Question 16

How will you disclose following items while preparing Cash Flow Statement of Gagan Ltd. as per AS-3 for the year ended 31st March, 20X2?

(i) 10% Debentures issued: As on 01-04-20X1 ₹ 1,10,000
As on 31-03-20X2 ₹ 77,000

(ii) Debentures were redeemed at 5% premium at the end of the year. Premium was charged to the Profit & Loss Account for the year.

(iii) Unpaid Interest on Debentures: As on 01-04-20X1 ₹ 275
As on 31-03-20X2 ₹ 1,175

(iv) Debtors of ₹ 36,000 were written off against the Provision for Doubtful Debts A/c during the year.

(v) 10% Bonds (Investments): As on 01-04-20X1 ₹ 3,50,000
As on 31-03-20X2 ₹ 3,50,000

(vi) Accrued Interest on Investments: As on 31-03-20X2 ₹ 10,500

(*Study Material*)

**Answer**

**Cash Flow Statement of M/s Gagan Ltd. for the year ended March 31, 20X2**

| | | |
|---|---|---|
| A | Cash Flow from Operating Activities | |
| | Net Profit as per Profit & Loss A/c | xxxxx |
| | Add: Premium on Redemption of Debentures | 1,650 |
| | Add: Interest on 10% Debentures | 11,000 |
| | Less: Interest on 10% Investments | (35,000) |
| B | Cash Flow from Investing Activities | |
| | Interest on Investments [35,000-10,500] | 24,500 |
| C | Cash Flow from Financing Activities | |
| | Interest on Debentures paid [11,000 - (1,175 - 275)] - outflow | (10,100) |
| | Redemption of Debentures [(1,10,000 - 77,000) at 5% premium] - outflow | (34,650) |

**Note: Debtors written off against provision for doubtful debts does not require any further adjustment in Cash Flow Statement.**

## Question 17

From the following Balance sheet of Grow More Ltd., prepare Cash Flow Statement for the year ended 31st March, 20X1:

| | | ***Particulars*** | ***Notes*** | **31st March, *20X1*** | **31st March, *20X0*** |
|---|---|---|---|---|---|
| | | **Equity and Liabilities** | | | |
| **1** | | **Shareholders' funds** | | | |
| | A | Share capital | | 10,00,000 | 8,00,000 |
| | B | Reserves and Surplus | 1 | 3,00,000 | 2,10,000 |
| **2** | | **Non-current liabilities** | | | |
| | | Long term borrowings | 2 | 2,00,000 | - |
| **3** | | **Current liabilities** | | | |
| | A | Trade Payables | | 7,00,000 | 8,20,000 |
| | B | Other current liabilities | 3 | - | 1,00,000 |
| | C | Short term provision (provision for tax) | | 1,00,000 | 70,000 |
| | | **Total** | | **23,00,000** | **20,00,000** |
| | | **Assets** | | | |
| **1** | | **Non-current assets** | | | |
| | A | Property, plant and Equipment | 4 | 13,00,000 | 9,00,000 |
| | B | Non-Current Investments | | 1,00,000 | - |
| **2** | | **Current assets** | | | |
| | A | Inventories | | 4,00,000 | 2,00,000 |
| | B | Trade receivables | | 5,00,000 | 7,00,000 |
| | C | Cash and Cash equivalents | | - | 2,00,000 |
| | | **Total** | | **23,00,000** | **20,00,000** |

**Notes to accounts**

| **No.** | **Particulars** | **31st March, *20X1*** | **31st March, *20X0*** |
|---|---|---|---|
| **1** | **Reserves and Surplus** | | |
| | Revenue reserve | 2,00,000 | 1,50,000 |
| | Profit and Loss account | 1,00,000 | 60,000 |
| | **Total** | **3,00,000** | **2,10,000** |
| **2** | **Long term borrowings** | | |
| | Debentures | 2,00,000 | -- |
| **3.** | **Other current liabilities** | | |
| | Dividend payable | - | 1,00,000 |
| **4** | **Property, plant and equipment** | | |
| | Plant and machinery | 7,00,000 | 5,00,000 |
| | Land and building | 6,00,000 | 4,00,000 |
| | **Net carrying value** | **13,00,000** | **9,00,000** |

(i) Depreciation @ 25% was charged on the opening value of Plant and Machinery.

(ii) At the year end, one old machine costing ₹ 50,000 (WDV ₹ 20,000) was sold for ₹ 35,000. Purchase was also made at the year end.

(iii) ₹ 50,000 was paid towards Income tax during the year.

(iv) Construction of the building got completed on 31.03.20X1 and hence no depreciation may be charged on the same.

Prepare Cash flow Statement.

(*Study Material*)

**Answer**

**Cash Flow Statement of Grow More Ltd for the year ended 31st March, 20X1**

**Cash Flow from Operating Activities**

| | | ₹ |
|---|---|---|
| Increase in balance of Profit and Loss Account (1,00,000 – 60,000) | 40,000 | |
| Provision for taxation (W.N.1) | 80,000 | |
| Transfer to General Reserve (2,00,000 – 1,50,000) | 50,000 | |
| Depreciation (W.N.2) | 1,25,000 | |
| Profit on sale of Plant and Machinery | (15,000) | |
| Operating Profit before Working Capital changes | 2,80,000 | |
| Increase in Inventories | (2,00,000) | |
| Decrease in Trade receivables | 2,00,000 | |
| Decrease in Trade payables | (1,20,000) | |
| Cash generated from operations | 1,60,000 | |
| Income tax paid | (50,000) | |
| Net Cash generated from operating activities | | 1,10,000 |

**Cash Flow from Investing Activities**

| | | |
|---|---|---|
| Purchase of fixed assets | (3,45,000) | |
| Expenses on building (6,00,000 – 4,00,000) | (2,00,000) | |
| Increase in investments | (1,00,000) | |
| Sale of old machine | 35,000 | |
| Net Cash used in investing activities | | (6,10,000) |

**Cash Flow from Financing activities**

| | | |
|---|---|---|
| Proceeds from issue of shares (10,00,000 – 8,00,000) | 2,00,000 | |
| Proceeds from issue of debentures | 2,00,000 | |
| Dividend paid | (1,00,000) | |
| Net cash generated from financing activities | | 3,00,000 |
| Net increase in cash or cash equivalents | | NIL |
| Cash and Cash equivalents at the beginning of the year | | 2,00,000 |
| Cash and Cash equivalents at the end of the year | | Nil |

**Working Notes:**

**1. Provision for taxation account**

| | | ₹ | | | ₹ |
|---|---|---|---|---|---|
| To | Cash (Paid) | 50,000 | By | Balance b/d | 70,000 |
| To | Balance c/d | 1,00,000 | By | Profit and Loss A/c (Balancing figure) | 80,000 |
| | | 1,50,000 | | | 1,50,000 |

**2. Plant and Machinery account**

| | | ₹ | | | ₹ |
|---|---|---|---|---|---|
| To | Balance b/d | 5,00,000 | By | Depreciation | 1,25,000 |
| To | Profit and Loss A/c (profit on sale of machine) | 15000 | | | |
| To | Cash (Balancing figure) | 3,45,000 | By | Cash (sale of machine) | 35,000 |
| | | | By | Balance c/d | 7,00,000 |
| | | 8,60,000 | | | 8,60,000 |

## Question 18

From the following Balance Sheets and information, prepare Cash Flow Statement of Ryan Ltd. by Indirect method for the year ended 31st March, 20X1:

| | | *Particulars* | *Notes* | *31st March 20X1* ₹ | *31st March 20X0* ₹ |
|---|---|---|---|---|---|
| | | **Equity and Liabilities** | | | |
| **1** | | **Shareholders' funds** | | | |
| | A | Share capital | 1 | 6,00,000 | 7,00,000 |
| | B | Reserves and Surplus | 2 | 4,20,000 | 3,00,000 |
| **2** | | **Non-current liabilities** | | | |
| | | Long term borrowings | 3 | 2,00,000 | - |
| **3** | | **Current liabilities** | | | |
| | A | Trade Payables | | 1,15,000 | 1,10,000 |
| | B | Other current liabilities | 4 | 30,000 | 80,000 |
| | C | Short term provision (provision for tax) | | 95,000 | 60,000 |
| | | **Total** | | **14,60,000** | **12,50,000** |
| | | **Assets** | | | |
| **1** | | **Non-current assets** | | | |
| | A | Property, plant and Equipment | 5 | 9,15,000 | 7,00,000 |
| | B | Non-Current Investments | | 50,000 | 80,000 |
| **2** | | **Current assets** | | | |
| | A | Inventories | | 95,000 | 90,000 |
| | B | Trade receivables | | 2,50,000 | 2,25,000 |
| | C | Cash and Cash equivalents | | 50,000 | 90,000 |
| | D | Other Current assets | | 1,00,000 | 65,000 |
| | | **Total** | | **14,60,000** | **12,50,000** |

**Notes to accounts**

| **No.** | | | **31st March, *20X1*** | **31st March, *20X0*** |
|---|---|---|---|---|
| **1.** | **Share capital** | | | |
| | Equity share capital | | 6,00,000 | 5,00,000 |
| | 10% Redeemable Preference share capital | | -- | 2,00,000 |
| | **Total** | | **6,00,000** | **7,00,000** |

| No. | | | 31st March, *20X1* | 31st March, *20X0* |
|---|---|---|---|---|
| 2 | **Reserves and Surplus** | | | |
| | Capital redemption reserve | | 1,00,000 | - |
| | Capital reserve | | 70,000 | - |
| | General reserve | | 1,50,000 | 2,50,000 |
| | Profit and Loss account | | 1,00,000 | 50,000 |
| | **Total** | | **4,20,000** | **3,00,000** |
| 3 | **Long term borrowings** | | | |
| | 9% Debentures | | 2,00,000 | -- |
| 4. | **Other current liabilities** | | | |
| | Dividend payable | | - | 60,000 |
| | Liabilities for expenses | | 30,000 | 20,000 |
| | **Total** | | **30,000** | **80,000** |
| 5 | **Property, plant and equipment** | | | |
| | Plant and machinery | | 7,65,000 | 5,00,000 |
| | Land and building | | 1,50,000 | 2,00,000 |
| | **Net carrying value** | | **9,15,000** | **7,00,000** |

**Additional Information:**

(i) A piece of land has been sold out for ₹1,50,000 (Cost – ₹1,20,000) and the balance land was revalued. Capital Reserve consisted of profit on revaluation of land.

(ii) On 1st April, 20X0 a plant was sold for ₹90,000 (Original Cost – ₹70,000 and W.D.V. – ₹ 50,000) and Debentures worth ₹1 lakh were issued at par as part consideration for plant of ₹4.5 lakhs acquired.

(iii) Part of the investments (Cost – ₹50,000) was sold for ₹70,000.

(iv) Pre-acquisition dividend received ₹5,000 was adjusted against cost of investment.

(v) Interim dividend was declared and paid @ 15% during the current year.

(vi) Income-tax liability for the current year was estimated at ₹1,35,000.

(vii) Depreciation @ 15% has been charged on Plant and Machinery but no depreciation has been charged on Building.

(*Study Material*)

**Answer**

**Cash Flow Statement of Ryan Limited For the year ended 31st March, 20X1**

| | ₹ | ₹ |
|---|---|---|
| Cash flow from operating activities Net Profit before taxation (W.N.1) | 2,75,000 | |
| Adjustment for | | |
| Depreciation (W.N.3) | 1,35,000 | |
| Profit on sale of land | (30,000) | |
| Profit on sale of plant (W.N.3) | (40,000) | |
| Profit on sale of investments (W.N.4) | (20,000) | |
| Interest on debentures (2,00,000 X 9%) | 18,000 | |
| Operating profit before working capital changes | 3,38,000 | |
| Increase in inventory | (5,000) | |
| Increase in trade receivables | (25,000) | |
| Increase in Other current assets (W.N.9) Increase in Trade payables | (35,000)<br>5,000 | |

| | ₹ | ₹ |
|---|---|---|
| Increase in liabilities for expenses | 10,000 | |
| Cash generated from operations | 2,88,000 | |
| Income taxes paid (W.N.8) | (1,00,000) | |
| Net cash generated from operating activities | | 1,88,000 |
| Cash flow from investing activities | | |
| Proceeds from sale of land (W.N.2) | 1,50,000 | |
| Proceeds from sale of plant (W.N.3) | 90,000 | |
| Proceeds from sale of investments (W.N.4) | 70,000 | |
| Purchase of plant (W.N.3) | (3,50,000) | |
| Purchase of investments (W.N.4) | (25,000) | |
| Pre-acquisition dividend received (W.N.4) | 5,000 | |
| Net cash used in investing activities | | (60,000) |
| Cash flow from financing activities | | |
| Proceeds from issue of equity shares (6,00,000 – 5,00,000) | 1,00,000 | |
| Proceeds from issue of debentures (2,00,000 – 1,00,000) | 1,00,000 | |
| Redemption of preference shares | (2,00,000) | |
| Dividends paid | (1,50,000) | |
| Interest paid on debentures | (18,000) | |
| Net cash used in financing activities | | (1,68,000) |
| Net decrease in cash and cash equivalents | | (40,000) |
| Cash and cash equivalents at the beginning of the year | | 90,000 |
| Cash and Cash equivalents at the end of the year | | 50,000 |

**Working Notes:**

**1.**

| | ₹ |
|---|---|
| Net profit before taxation | |
| Retained profit | 1,00,000 |
| *Less:* Balance as on 31.3.20X0 | (50,000) |
| | 50,000 |
| Provision for taxation | 1,35,000 |
| Dividend | 90,000 |
| | 2,75,000 |

**2.** **Land and Building Account**

| | | ₹ | | | ₹ |
|---|---|---|---|---|---|
| To | Balance b/d | 2,00,000 | By | Cash (Sale) | 1,50,000 |
| To | Profit and Loss A/c (Profit on sale) | 30,000 | By | Balance c/d | 1,50,000 |
| To | Capital reserve (Revaluation profit) | 70,000 | | | |
| | | 3,00,000 | | | 3,00,000 |

**3. Plant and Machinery Account**

| | | ₹ | | | ₹ |
|---|---|---|---|---|---|
| To | Balance b/d | 5,00,000 | By | Cash (Sale) | 90,000 |
| To | Profit and loss account | 40,000 | By | Depreciation | 1,35,000 |
| To | Debentures | 1,00,000 | By | Balance c/d | 7,65,000 |
| To | Bank | 3,50,000 | | | |
| | | 9,90,000 | | | 9,90,000 |

**4. Investments Account**

| | | ₹ | | | ₹ |
|---|---|---|---|---|---|
| To | Balance b/d | 80,000 | By | Cash (Sale) | 70,000 |
| To | Profit and loss account | 20,000 | By | Dividend | |
| To | Bank (Balancing figure) | 25,000 | | (Pre-acquisition) | 5,000 |
| | | | By | Balance c/d | 50,000 |
| | | 1,25,000 | | | 1,25,000 |

**5. Capital Reserve Account**

| | | ₹ | | | ₹ |
|---|---|---|---|---|---|
| To | Balance c/d | 70,000 | By | Profit on revaluation of land | 70,000 |
| | | 70,000 | | | 70,000 |

**6. General Reserve Account**

| | | ₹ | | | ₹ |
|---|---|---|---|---|---|
| To | Capital redemption reserve | 1,00,000 | By | Balance b/d | 2,50,000 |
| To | Balance c/d | 1,50,000 | | | |
| | | 2,50,000 | | | 2,50,000 |

**7. Dividend payable Account**

| | | ₹ | | | ₹ |
|---|---|---|---|---|---|
| To | Bank (Balancing figure) | 1,50,000 | By | Balance b/d | 60,000 |
| To | Balance c/d | - | By | Profit and loss account | 90,000 |
| | | 1,50,000 | | | 1,50,000 |

**8. Provision for Taxation Account**

| | | ₹ | | | ₹ |
|---|---|---|---|---|---|
| To | Bank (Balancing figure) | 1,00,000 | By | Balance b/d | 60,000 |
| To | Balance c/d | 95,000 | By | Profit and loss account | 1,35,000 |
| | | 1,95,000 | | | 1,95,000 |

**9. Other Current Assets Account**

| | | ₹ | | | ₹ |
|---|---|---|---|---|---|
| To | Balance b/d | 65,000 | | | |
| To | Bank (Balancing figure) | 35,000 | By | Balance c/d | 1,00,000 |
| | | 1,00,000 | | | 1,00,000 |

## Question 19

The Balance Sheet of New Light Ltd. as at 31st March, 20X1 and 20X0 (for the years ended) are as follows:

| | | | Notes | ₹ 31st March 20X0 | ₹ 31st March 20X1 |
|---|---|---|---|---|---|
| | | **Equity and Liabilities** | | | |
| **1** | | **Shareholders' funds** | | | |
| | A | Share capital | 1 | 16,00,000 | 18,80,000 |
| | B | Reserves and Surplus | 2 | 8,40,000 | 11,00,000 |
| **2** | | **Non-current liabilities** | | | |
| | | Long term borrowings | 3 | 4,00,000 | 2,80,000 |
| **3** | | **Current liabilities** | | | |
| | A | Other current liabilities | 4 | 6,00,000 | 5,20,000 |
| | B | Short term provision (provision for tax) | | 3,60,000 | 3,40,000 |
| | | **Total** | | **38,00,000** | **41,20,000** |
| | | **Assets** | | | |
| **1** | | **Non-current assets** | | | |
| | A | Property, plant and Equipment | 5 | 22,80,000 | 26,40,000 |
| | B | Non-Current Investments | | 4,00,000 | 3,20,000 |
| **2** | | **Current assets** | | | |
| | A | Cash and Cash equivalents | | 10,000 | 10,000 |
| | B | Other Current assets | | 11,10,000 | 11,50,000 |
| | | **Total** | | **38,00,000** | **41,20,000** |

**Notes to accounts**

| No. | Particulars | | 31st March, 20X0 | 31st March, 20X1 |
|---|---|---|---|---|
| **1.** | **Share capital** | | | |
| | Equity share capital | | 12,00,000 | 16,00,000 |
| | 10% Preference share capital | | 4,00,000 | 2,80,000 |
| | **Total** | | **16,00,000** | **18,80,000** |
| **2** | **Reserves and Surplus** | | | |
| | General reserve | | 6,00,000 | 7,60,000 |
| | Profit and Loss account | | 2,40,000 | 3,40,000 |
| | **Total** | | **8,40,000** | **11,00,000** |
| **3** | **Long term borrowings** | | | |
| | 9% Debentures | | 4,00,000 | 2,80,000 |
| | **Total** | | **4,00,000** | **2,80,000** |
| **4.** | **Other current liabilities** | | | |
| | Dividend payable | | 1,20,000 | - |
| | Current Liabilities | | 4,80,000 | 5,20,000 |
| | **Total** | | **6,00,000** | **5,20,000** |

| No. | Particulars | | 31st March, *20X0* | 31st March, *20X1* |
|---|---|---|---|---|
| 5 | **Property, plant and equipment** | | | |
| | Property, plant and equipment | | 32,00,000 | 38,00,000 |
| | Less: Depreciation | | (9,20,000) | (11,60,000) |
| | **Net carrying value** | | **22,80,000** | **26,40,000** |

**Additional information:**

**(i)** The company sold one property, plant and equipment for ₹ 1,00,000, the cost of which was ₹ 2,00,000 and the depreciation provided on it was ₹80,000.

**(ii)** The company also decided to write off another item of property, plant and equipment costing ₹ 56,000 on which depreciation amounting to ₹ 40,000 has been provided.

**(iii)** Depreciation on property, plant and equipment provided ₹ 3,60,000.

**(iv)** Company sold some investment at a profit of ₹ 40,000.

**(v)** Debentures and preference share capital redeemed at 5% premium.

**(vi)** Company decided to value inventory at cost, whereas previously the practice was to value inventory at cost less 10%. The inventory according to books on 31.3.20X0 was ₹ 2,16,000. The inventory on 31.3.20X1 was correctly valued at ₹ 3,00,000.

Prepare Cash Flow Statement as per revised Accounting Standard 3 by indirect method.

(*Study Material*)

**Answer**

**New Light Ltd.**

**Cash Flow Statement for the year ended 31st March, 20X1**

| A. | Cash Flow from operating activities | ₹ | ₹ |
|---|---|---|---|
| | Profit after appropriation | | |
| | Increase in profit and loss A/c after inventory adjustment [₹3,40,000 – (₹2,40,000 + ₹24,000)] | 76,000 | |
| | Transfer to general reserve | 1,60,000 | |
| | Provision for tax | 3,40,000 | |
| | Net profit before taxation and extraordinary item | 5,76,000 | |
| | Adjustments for: | | |
| | Depreciation | 3,60,000 | |
| | Loss on sale of property, plant and equipment | 20,000 | |
| | Decrease in value of property, plant and equipment | 16,000 | |
| | Profit on sale of investment | (40,000) | |
| | Premium on redemption of preference share capital | 6,000 | |
| | Premium on redemption of debentures | 6,000 | |
| | Operating profit before working capital changes | 9,44,000 | |
| | Increase in current liabilities (₹5,20,000 –₹4,80,000) | 40,000 | |
| | Increase in other current assets [₹11,50,000 – (₹ 11,10,000 + ₹24,000)] | (16,000) | |
| | Cash generated from operations | 9,68,000 | |
| | Income taxes paid | (3,60,000) | |
| | Net Cash generated from operating activities | | 6,08,000 |

| | | | |
|---|---|---|---|
| **B.** | **Cash Flow from investing activities** | | |
| | Purchase of property, plant and equipment (W.N.3) | (8,56,000) | |
| | Proceeds from sale of property, plant and equipment (W.N.3) | 1,00,000 | |
| | Proceeds from sale of investments (W.N.2) | 1,20,000 | |
| | Net Cash used in investing activities | | (6,36,000) |
| **C.** | **Cash Flow from financing activities** | | |
| | Proceeds from issuance of share capital | 4,00,000 | |
| | Redemption of preference share capital (₹1,20,000 + ₹6,000) | (1,26,000) | |
| | Redemption of debentures (₹ 1,20,000 + ₹ 6,000) | (1,26,000) | |
| | Dividend paid | (1,20,000) | |
| | Net Cash generated from financing activities | | 28,000 |
| | Net increase/decrease in cash and cash equivalent during the year | | Nil |
| | Cash and cash equivalent at the beginning of the year | | 10,000 |
| | Cash and cash equivalent at the end of the year | | 10,000 |

**Working Notes:**

**1.** Revaluation of inventory will increase opening inventory by ₹ 24,000. 2,16,000/90 x 10 = ₹ 24,000

Therefore, opening balance of other current assets would be as follows:

₹ 11,10,000 + ₹ 24,000 = ₹ 11,34,000

Due to under valuation of inventory, the opening balance of profit and loss account be increased by ₹ 24,000.

The opening balance of profit and loss account after revaluation of inventory will be ₹ 2,40,000 + ₹ 24,000 = ₹ 2,64,000

**2. Investment Account**

| | | ₹ | | | ₹ |
|---|---|---|---|---|---|
| To | Balance b/d Profit and Loss A/c | 4,00,000 | By | Bank A/c (balancing figure being investment sold) | 1,20,000 |
| To | (Profit on sale of investment) | 40,000 | By | Balance c/d | 3,20,000 |
| | | 4,40,000 | | | 4,40,000 |

**3. Property, Plant and Equipment Account**

| | | ₹ | | | ₹ | ₹ |
|---|---|---|---|---|---|---|
| To | Balance b/d | 32,00,000 | By | Bank A/c (sale of assets) | 1,00,000 | |
| To | Bank A/c (balancing figure being assets purchased) | 8,56,000 | By | Accumulated depreciation A/c | 80,000 | |
| | | | By | Profit and loss A/c(loss on sale of assets) | 20,000 | 2,00,000 |
| | | | By | Accumulated depreciation A/c | 40,000 | |
| | | | By | Profit and loss A/c (assets written off) | 16,000 | 56,000 |
| | | | By | Balance c/d | | 38,00,000 |
| | | 40,56,000 | | | | 40,56,000 |

**4.** **Accumulated Depreciation Account**

| | | ₹ | | | ₹ |
|---|---|---|---|---|---|
| To | Property, plant and equipment A/c | 80,000 | By | Balance b/d | 9,20,000 |
| To | Property, plant and equipment A/c | 40,000 | By | Profit and loss A/c (depreciation for the year) | 3,60,000 |
| To | Balance c/d | 11,60,000 | | | |
| | | 12,80,000 | | | 12,80,000 |

## Question 20

ABC Ltd. gives you the Balance sheets as at 31st March 20X0 and 31st March 20X1. You are required to prepare Cash Flow Statement by using indirect method as per AS 3 for the year ended 31st March 20X1:

| | | *Particulars* | *Notes* | *₹ 31st March 20X0* | *₹ 31st March 20X1* |
|---|---|---|---|---|---|
| | | **Equity and Liabilities** | | | |
| **1** | | **Shareholders' funds** | | | |
| | A | Share capital | | 50,00,000 | 50,00,000 |
| | B | Reserves and Surplus | | 26,50,000 | 36,90,000 |
| **2** | | **Non-current liabilities** | | | |
| | | Long term borrowings | 1 | - | 9,00,000 |
| **3** | | **Current liabilities** | | | |
| | A | Short-term borrowings (Bank loan) | | 1,50,000 | 3,00,000 |
| | B | Trade payables | | 8,80,000 | 8,20,000 |
| | C | Other current liabilities | 2 | 4,80,000 | 2,70,000 |
| | | **Total** | | **91,60,000** | **1,09,80,000** |

| | | | | | |
|---|---|---|---|---|---|
| | | **Assets** | | | |
| **1** | | **Non-current assets** | | | |
| | A | Property, plant and Equipment | 3 | 21,20,000 | 32,80,000 |
| **2** | | **Current assets** | | | |
| | A | Current Investments | | 11,80,000 | 15,00,000 |
| | B | Inventory | | 20,10,000 | 19,20,000 |
| | C | Trade receivables | 4 | 22,40,000 | 26,40,000 |
| | D | Cash and Cash equivalents | | 15,20,000 | 15,20,000 |
| | E | Other Current assets (Prepaid expenses) | | 90,000 | 1,20,000 |
| | | **Total** | | **91,60,000** | **1,09,80,000** |

**Notes to accounts**

| **No.** | **Particulars** | | *₹20X0* | *20X1* |
|---|---|---|---|---|
| **1** | **Long term borrowings** | | | |
| | 9% Debentures | | - | 9,00,000 |
| | **Total** | | **-** | **9,00,000** |
| **2.** | **Other current liabilities** | | | |
| | Dividend payable | | 1,50,000 | - |
| | Liabilities for expenses | | 3,30,000 | 2,70,000 |
| | **Total** | | **4,80,000** | **2,70,000** |

| No. | Particulars | | ₹20X0 | 20X1 |
|---|---|---|---|---|
| **3** | **Property, plant and equipment** | | | |
| | Plant and machinery | | 27,30,000 | 40,70,000 |
| | Less: Depreciation | | (6,10,000) | (7,90,000) |
| | **Net carrying value** | | **21,20,000** | **32,80,000** |
| **4** | **Trade receivables** | | | |
| | Gross amount | | 23,90,000 | 28,30,000 |
| | Less: Provision for doubtful debts | | (1,50,000) | (1,90,000) |
| | **Total** | | **22,40,000** | **26,40,000** |

**Additional Information:**

(i) Net profit for the year ended 31st March, 20X1, after charging depreciation ₹ 1,80,000 is ₹ 10,40,000.

(ii) Trade receivables of ₹ 2,30,000 were determined to be worthless and were written off against the provisions for doubtful debts account during the year.

(*Study Material*)

**Answer**

**Cash Flow Statement of ABC Ltd. for the year ended 31.3.20X1**

| **Cash flows from Operating Activities** | | ₹ | ₹ |
|---|---|---|---|
| **Net Profit** | | 10,40,000 | |
| *Add:* Adjustment For Depreciation (₹7,90,000 – ₹6,10,000) | | 1,80,000 | |
| Add: Adjustment for Provision for Doubtful Debts (₹ 4,20,000 – ₹1,50,000) | | 2,70,000 | |
| Operating Profit Before Working Capital Changes | | 14,90,000 | |
| *Add:* Decrease in Inventories (₹ 20,10,000 – ₹ 19,20,000) | | 90,000 | |
| | | 15,80,000 | |
| Less: Increase in Current Assets | | | |
| Trade Receivables | | | |
| (₹ 30,60,000 – ₹23,90,000) | 6,70,000 | | |
| Prepaid Expenses (₹ 1,20,000 – ₹90,000) | 30,000 | | |
| Decrease in Current Liabilities: | | | |
| Trade Payables (₹ 8,80,000 – ₹ 8,20,000) | 60,000 | | |
| Expenses Outstanding | | | |
| (₹ 3,30,000 – ₹ 2,70,000) | 60,000 | (8,20,000) | |
| *Net Cash generated from Operating Activities* | | | 7,60,000 |
| **Cash Flows from Investing Activities** | | | |
| Investment in Current Investments Purchase of Plant & Machinery (₹ 40,70,000 – ₹ 27,30,000) | | (3,20,000)<br>(13,40,000) | |
| *Net Cash Used in Investing Activities* | | | (16,60,000) |
| **Cash Flows from Financing Activities** | | | |
| Bank Loan Raised (₹ 3,00,000 – ₹ 1,50,000) | | 1,50,000 | |
| Issue of Debentures | | 9,00,000 | |
| Payment of Dividend | | (1,50,000) | |
| **Net Cash Used in Financing Activities** | | | 9,00,000 |
| Net Increase in Cash During the Year | | | - |
| *Add:* Cash and Cash Equivalents as on 1.4.20X0 | | | 15,20,000 |
| Cash and Cash Equivalents as on 31.3.20X1 | | | 15,20,000 |

**Note:**

1. Bad debts amounting ₹ 2,30,000 were written off against provision for doubtful debts account during the year. In the above solution, Bad debts have been added back in the balances of provision for doubtful debts and trade receivables as on 31.3.20X1. Alternatively, the adjustment of writing off bad debts may be ignored and the solution can be given on the basis of figures of trade receivables and provision for doubtful debts as appearing in the balance sheet on 31.3.20X1.
2. Current investments (i.e. Marketable securities) may not be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value as per the requirements of AS 3 and hence those have been considered as investing activities.

# Test Your Knowledge
# MCQ

1. While preparing cash flow statement, conversion of debt to equity
   (a) Should be shown as a financing activity.
   (b) Should be shown as an investing activity.
   (c) Should not be shown as it is a non-cash transaction.

**Answer:** (c)

2. Which of the following would be considered a 'cash-flow item from an "investing" activity'?
   (a) Cash outflow to the government for taxes.
   (b) Cash outflow to purchase bonds issued by another company.
   (c) Cash outflow to shareholders as dividends.

**Answer:** (b)

3. All of the following would be included in a company's operating activities except:
   (a) Income tax payments
   (b) Collections from customers or Cash payments to suppliers
   (c) Dividend payments.

**Answer:** (c)

4. Hari Uttam, a stock broking firm, received ₹ 1,50,000 as premium for forward contracts entered for purchase of equity shares. How will you classify this amount in the cash flow statement of the firm?
   (a) Operating Activities.
   (b) Investing Activities.
   (c) Financing Activities.

**Answer:** (a)

5. As per AS 3 on Cash Flow Statements, cash received by a manufacturing company from sale of shares of ABC Company Ltd. should be classified as
   (a) Operating activity.
   (b) Financing activity.
   (c) Investing activity.

**Answer:** (c)

6. Which of the following activities would generally be regarded as a financing activity in preparing a cash flow statement?
   (a) Dividend distribution.
   (b) Proceeds from the sale of shares of other companies.
   (c) Loans made by the financial enterprise to other businesses entities.

**Answer:** (a)

7. All of the following are examples of cash flows arising from investing activities except
   (a) Cash payments to acquire fixed assets.
   (b) Cash receipts from disposal of fixed assets.
   (c) Cash payments to suppliers for goods and services.

**Answer:** (c)

**8.** Cash repayments of amounts borrowed will be disclosed in the cash flow statement as

(a) An operating activity.

(b) A financing activity

(c) An investing activity.

**Answer:** (b)

**9.** In the cash flow statement, ‘cash and cash equivalents’ include

(a) Bank balances and Cash balances.

(b) Short-term investments readily convertible into Cash are subject to an insignificant risk of changes in value.

(c) Both (a) and (b).

**Answer:** (c)

**10.** While preparing a Cash Flow Statement using the Indirect method as required under AS 3, which of the following will be deducted from the Net Profit to arrive at the “Cash flow from Operating activities”?

(a) Interest income

(b) Gain on sale of a Fixed asset.

(c) Both (a) and (b)

**Answer:** (c)

**11.** XYZ Co. Ltd is a financial Institute and has given loans and advances to its subsidiary and earned interest of ₹ 5 lacs on that loan. Interest earned by XYZ Co. Ltd is shown as

(a) Operating Cash Flow.

(b) Investing Cash Flow.

(c) Financing Cash Flow.

**Answer:** (a)

# QUESTION BANK

## Question 21

The following information was provided by M/s PQR Ltd. for the year ended 31st March, 2019:

(1) Gross Profit Ratio was 25% for the year, it amounts to ₹ 3,75,000.
(2) Company sold goods for cash only.
(3) Opening inventory was lesser than closing inventory by ₹ 25,000.
(4) Wages paid during the year ₹ 5,55,000.
(5) Office expenses paid during the year ₹ 35,000.
(6) Selling expenses paid during the year ₹ 15,000.
(7) Dividend paid during the year ₹ 40,000 (including dividend distribution tax).
(8) Bank Loan repaid during the year ₹ 2,05,000 (included interest ₹ 5,000)
(9) Trade payable on 31st March, 2018, were ₹ 50,000 and on 31st March, 2019 were ₹ 35,000.
(10) Amount paid to Trade payables during the year ₹ 6,10,000
(11) Income Tax paid during the year amounts to ₹ 55,000
(Provision for taxation as on 31st March, 2019, ₹ 30,000)
(12) Investments of ₹ 8,20,000 sold during the year at a profit of ₹ 20,000.
(13) Depreciation on other tangible assets amounts to ₹ 40,000.
(14) Depreciation on other tangible assets amounts to ₹ 20,000.
(15) Plant and Machinery purchases on 15th November, 2018 for ₹ 3,50,000.
(16) On 31st March, 2019 ₹ 2,00,000, 7% Debentures issued at face value in an exchange for a plant.
(17) Cash and Cash equivalents on 31st March, 2018 ₹ 2,25,000.
 (A) Prepare cash flow statement for the ended 31st March, 2019, using direct method.
 (B) Calculate cash flow from operating activities, using indirect method.

(*May 2019*) (*10 Marks*)

**Answer**

**(i)** **PQR Ltd.**

**Cash Flow Statement for the year ended 31st March, 2019 (Using direct method)**

| *Particulars* | ₹ | ₹ |
|---|---|---|
| *Cash flows from Operating Activities* | | |
| Cash sales (₹ 3,75,000/25%) | | 15,00,000 |
| *Less:* Cash payments for trade payables | (6,10,000) | |
| Wages Paid | (5,55,000) | |
| Office and selling expenses ₹ (35,000 + 15,000) | (50,000) | (12,15,000) |
| Cash generated from operations before taxes | | 2,85,000 |
| Income tax paid | | (55,000) |
| Net cash generated from operating activities (A) | | 2,30,000 |
| *Cash flows from Investing activities* | | |
| Sale of investments ₹ (8,20,000 + 20,000) | 8,40,000 | |
| Payments for purchase of Plant & machinery | (3,50,000) | |
| Net cash used in investing activities (B) | | 4,90,000 |
| *Cash flows from financing activities* | | |
| Bank loan repayment (including interest) | (2,05,000) | |
| Dividend paid (including dividend distribution tax) | (40,000) | |
| Net cash used in financing activities (C) | | (2,45,000) |
| Net increase in cash (A+B+C) | | 4,75,000 |
| Cash and cash equivalents at beginning of the period | | 2,25,000 |
| Cash and cash equivalents at end of the period | | 7,00,000 |

**(ii) 'Cash Flow from Operating Activities' by indirect method**

| | | ₹ |
|---|---|---|
| Net Profit for the year before tax and extraordinary items | | 2,80,000 |
| *Add*: Non-Cash and Non-Operating Expenses: | | |
| Depreciation | | 60,000 |
| Interest Paid | | 5,000 |
| *Less*: Non-Cash and Non-Operating Incomes: | | |
| Profit on Sale of Investments | | (20,000) |
| Net Profit after Adjustment for Non-Cash Items | 15,000 | 3,25,000 |
| Less: Decrease in trade payables | 25,000 | |
| Increase in inventory | | (40,000) |
| Cash generated from operations before taxes | | 2,85,000 |

**Working Note:**

**Calculation of net profit earned during the year**

| | ₹ | ₹ |
|---|---|---|
| Gross profit | | 3,75,000 |
| Less: Office expenses, selling expenses | 50,000 | |
| Depreciation | 60,000 | |
| Interest paid | 5,000 | (1,15,000) |
| | | 2,60,000 |
| Add: Profit on sale of investments | | 20,000 |
| Net profit before tax | | 2,80,000 |

## Question 22

Preet Ltd. presents you the following information for the year ended 31st March, 2019:

| | | ***(₹ in lacs)*** |
|---|---|---|
| (i) | Net profit before tax provision | 72,000 |
| (ii) | Dividend paid | 20,404 |
| (iii) | Income-tax paid | 10,200 |
| (iv) | Book value of assets sold | 444 |
| | Loss on sale of asset | 96 |
| (v) | Depreciation debited to P & L account | 48,000 |
| (vi) | Capital grant received-amortized to P & L A/c | 20 |
| (vii) | Book value of investment sold | 66,636 |
| | Profit on sale of investment | 240 |
| (viii) | Interest income from investment credited to P & L A/c | 6,000 |
| (ix) | Interest expenditure debited to P & L A/c | 24,000 |
| (x) | Interest actually paid (Financing activity) | 26,084 |
| (xi) | Increase in working capital<br>[Excluding c ash and bank balance] | 1,34,580 |
| (xii) | Purchase of fixed assets | 44,184 |
| (xiii) | Expenditure on construction work | 83,376 |
| xiv) | Grant received for capital projects | 36 |
| (xv) | Long term borrowings from banks | 1,11,732 |
| (xvi) | Provision for Income-tax debited to P & L A/c | 12,000 |
| | Cash and bank balance on 1.4.2018 | 12,000 |
| | Cash and bank balance on 31.3.2019 | 16,000 |

You are required to prepare a cash flow statement as per AS-3 (Revised).

(*RTP May 2019*)

**Answer:**

**Cash Flow Statement as per AS 3**

| ***Cash flows from operating activities:*** | | ***₹ in lacs*** |
|---|---|---|
| Net profit before tax provision | | 72,000 |
| *Add:* Non c ash expenditures: | | |
| Depreciation | 48,000 | |
| Loss on sale of assets | 96 | |
| Interest expenditure (non-operating activity) | 24,000 | 72,096 |
| | | 1,44,096 |
| *Less:* Non cash income | | |
| Amortisation of capital grant received | (20) | |
| Profit on sale of investments (non-operating income) | (240) | |
| Interest income from investments (non-operating income) | (6,000) | 6,260 |
| Operating profit | | 1,37,836 |
| *Less:* Increase in working capital | | (1,34,580) |
| Cash from operations | | 3,256 |
| *Less:* Income tax paid | | (10,200) |
| Net cash generated from operating activities | | (6,944) |
| *Cash flows from investing activities:* | | |
| Sale of assets (444 – 96) | 348 | |
| Sale of investments (66,636+240) | 66,876 | |
| Interest income from investments | 6,000 | |
| Purchase of fixed assets | (44,184) | |
| Expenditure on construction work | (83,376) | |
| Net cash used in investing activities | | (54,336) |
| *Cash flows from financing activities:* | | |
| Grants for capital projects | 36 | |
| Long term borrowings | 1,11,732 | |
| Interest paid | (26,084) | |
| Dividend paid | (20,404) | |
| Net c ash from financing activities | | 65,280 |
| Net increase in c ash | | 4,000 |
| *Add:* Cash and bank balance as on 1.4.2018 | | 12,000 |
| Cash and bank balance as on 31.3.2019 | | 16,000 |

## Question 23

The Balance Sheet of Harry Ltd. for the year ending 31st March, 2018 and 31st March, 2017 were summarised as follows:

| | **2018 (₹)** | **2017 (₹)** |
|---|---|---|
| Equity share capital | 1,20,000 | 1,00,000 |
| Reserves: | | |
| Profit and Loss Account | 9,000 | 8,000 |
| Current Liabilities: | | |
| Trade Payables | 8,000 | 5,000 |
| Income tax payable | 3,000 | 2,000 |
| Declared Dividends | 4,000 | 2,000 |
| | 1,44,000 | 1,17,000 |
| Fixed Assets (at W.D.V): | | |
| Building | 19,000 | 20,000 |
| Furniture & Fixture | 34,000 | 22,000 |
| Cars | 25,000 | 16,000 |
| Long Term Investments | 32,000 | 28,000 |

| | 2018 (₹) | 2017 (₹) |
|---|---|---|
| Current Assets: | | |
| Inventory | 14,000 | 8,000 |
| Trade Receivables | 8,000 | 6,000 |
| Cash & Bank | 12,000 | 17,000 |
| | 1,44,000 | 1,17,000 |

The Profit and Loss account for the year ended 31st March, 2018 disclosed:

| | ₹ |
|---|---|
| Profit before tax | 8,000 |
| Income Tax | (3,000) |
| Profit after tax | 5,000 |
| Declared Dividends | (4,000) |
| Retained Profit | 1,000 |

Further Information is available:

1. Depreciation on Building ₹ 1,000.
2. Depreciation on Furniture & Fixtures for the year ₹ 2,000.
3. Depreciation on Cars for the year ₹ 5,000. One car was disposed during the year for ₹ 3,400 whose written down value was ₹ 2,000.
4. Purchase investments for ₹ 6,000.
5. Sold investments for ₹ 10,000, these investments cost ₹ 2,000.
   You are required to prepare Cash Flow Statement as per AS-3 (revised) using indirect method.

(*RTP November 2018*)

**Answer:**

**Harry Ltd.**
**Cash Flow Statement**
**for the year ended 31st March, 2018**

| | ₹ | ₹ |
|---|---|---|
| Cash flows from operating activities | | |
| Net Profit before taxation | 8,000 | |
| Adjustments for: | | |
| Depreciation (1,000 + 2,000 + 5,000) | 8,000 | |
| Profit on sale of Investment | (8,000) | |
| Profit on sale of car | (1,400) | |
| Operating profit before working capital changes | 6,600 | |
| Increase in Trade receivables | (2,000) | |
| Increase in inventories | (6,000) | |
| Increase in Trade payables | 3,000 | |
| Cash generated from operations | 1,600 | |
| Income taxes paid | (2,000) | |
| *Net cash generated from operating activities (A)* | | (400) |
| **Cash flows from investing activities** | | |
| Sale of car | 3,400 | |
| Purchase of car | (16,000) | |
| Sale of Investment | 10,000 | |
| Purchase of Investment | (6,000) | |
| Purchase of Furniture & fixtures | (14,000) | |
| *Net cash used in investing activities (B)* | | (22,600) |
| **Cash flows from financing activities** | | |
| Issue of shares for cash | 20,000 | |
| Dividends paid* | (2,000) | |
| *Net cash from financing activities(C)* | | 18,000 |
| Net decrease in cash and cash equivalents (A + B +C) | | (5,000) |
| Cash and cash equivalents at beginning of period | | 17,000 |
| Cash and cash equivalents at end of period | | 12,000 |

*Dividend declared for the year ended 31st March, 2017 amounting ₹ 2,000 must have been paid in the year 2017-18. Hence, it has been considered as cash outflow for preparation of cash flow statement of 2017-18.

**Working Notes:**

**1. Calculation of Income taxes paid**

| | ₹ |
|---|---:|
| Income tax expense for the year | 3,000 |
| Add: Income tax liability at the beginning of the year | 2,000 |
| | 5,000 |
| Less: Income tax liability at the end of the year | (3,000) |
| | 2,000 |

**2. Calculation of Fixed assets acquisitions**

| | Furniture & Fixtures (₹) | Car (₹) |
|---|---:|---:|
| W.D.V. at 31.3.2018 | 34,000 | 25,000 |
| Add back: Depreciation for the year | 2,000 | 5,000 |
| Disposals | — | 2,000 |
| | 36,000 | 32,000 |
| Less: W.D.V. at 31.3. 2017 | (22,000) | (16,000) |
| Acquisitions during 2016-2018 | 14,000 | 16,000 |

## Similar Question

### Question 23A

From the following details relating to the accounts of Omega Ltd. prepare Cash Flow Statement for the year ended 31st March, 2021:

| | 31.03.2021 (₹) | 31.03.2020 (₹) |
|---|---:|---:|
| Share Capital | 14,00,000 | 11,20,000 |
| General Reserve | 5,60,000 | 3,50,000 |
| Profit and Loss Account | 1,40,000 | 84,000 |
| Debentures | 2,80,000 | - |
| Provision for taxation | 1,40,000 | 98,000 |
| Trade payables | 9,80,000 | 11,48,000 |
| Plant and Machinery | 9,80,000 | 7,00,000 |
| Land and Building | 8,40,000 | 5,60,000 |
| Investments | 1,40,000 | - |
| Trade receivables | 7,00,000 | 9,80,000 |
| Inventories | 5,60,000 | 2,80,000 |
| Cash in hand and at Bank | 2,80,000 | 2,80,000 |

(i) Depreciation @ 20% was charged on the opening value of Plant and Machinery.

(ii) At the year end, one old machine costing 70,000 (WDV 28,000) was sold for ₹ 49,000. Purchase of machinery was also made at the year end.

(iii) ₹ 70,000 was paid towards Income tax during the year.

(iv) Land & Building is not subject to any depreciation. Expenses on renovation of building amount ₹2,80,000 were incurred during the year.

Prepare Cash Flow Statement.

*(RTP May, 2022)*

**Answer**

**Omega Ltd.**

**Cash Flow Statement for the year ended 31st March, 2021**

| **Cash Flow from Operating Activities** | | |
|---|---:|---:|
| Increase in balance of Profit and Loss Account | 56,000 | |
| Provision for taxation | 1,12,000 | |
| Transfer to General Reserve | 2,10,000 | |
| Depreciation | 1,40,000 | |
| Profit on sale of Plant and Machinery | (21,000) | |
| Operating Profit before Working Capital changes | 4,97,000 | |
| Increase in Inventories | (2,80,000) | |
| Decrease in Trade receivables | 2,80,000 | |

| | | |
|---|---|---|
| Decrease in Trade payables | (1,68,000) | |
| Cash generated from operations | 3,29,000 | |
| Income tax paid | (70,000) | |
| Net Cash from operating activities | | 2,59,000 |
| **Cash Flow from Investing Activities** | | |
| Purchase of plant & machinery | (4,48,000) | |
| Expenses on building | (2,80,000) | |
| Increase in investments | (1,40,000) | |
| Sale of old machine | 49,000 | |
| Net Cash used in investing activities | | (8,19,000) |
| **Cash Flow from Financing activities** | | |
| Proceeds from issue of shares | 2,80,000 | |
| Proceeds from issue of debentures | 2,80,000 | |
| Net cash from financing activities | | 5,60,000 |
| Net increase in cash or cash equivalents | | NIL |
| Cash and Cash equivalents at the beginning of the year | | 2,80,000 |
| Cash and Cash equivalents at the end of the year | | 2,80,000 |

**Working Notes:**

**Provision for taxation account**

| | | ₹ | | | ₹ |
|---|---|---|---|---|---|
| To | Cash (Tax Paid) | 70,000 | By | Balance b/d | 98,000 |
| To | Balance c/d | 1,40,000 | By | Profit and Loss A/c (Balancing figure) | 1,12,000 |
| | | 2,10,000 | | | 2,10,000 |

**Plant and Machinery account**

| | | ₹ | | | ₹ |
|---|---|---|---|---|---|
| To | Balance b/d | 7,00,000 | By | Depreciation | 1,40,000 |
| To | Profit and Loss A/c (profit on sale of machine) | 21,000 | | | |
| To | Cash (Balancing figure) | 4,48,000 | By | Cash (sale of machine) | 49,000 |
| | | | By | Balance c/d | 9,80,000 |
| | | 11,69,000 | | | 11,69,000 |

## Question 24

Classify the following activities as

(i) Operating Activities,
(ii) Investing activities,
(iii) Financial activities and
(iv) Cash Equivalents.

(1) Cash receipts from Trade Receivables
(2) Marketable Securities
(3) Purchase of investment
(4) Proceeds from long term borrowings
(5) Wages and Salaries paid
(6) Bank overdraft
(7) Purchase of Goodwill
(8) Interim dividend paid on equity shares
(9) Short term Deposits
(10) Underwriting commission paid

(*May 2018*) (*4 Marks*)

**Answer:**

(a) Operating Activities: Items 1 and 5.
(b) Investing Activities: Items 3, 7 and 9
(c) Financing Activities: Items 4, 6, 8 and 10
(d) Cash Equivalent: 2

## Question 25

A company provides you the following information:

(i) Total sales for the year were ₹ 398 crores out of which cash sales amounted to ₹ 262 crores.

(ii) Receipts from credit customers during the year, aggregated ₹ 134 crores.

(iii) Purchases for the year amounted to ₹ 220 crores out of which credit purchase was 80%.
Balance in creditors as on
1.4.2016 ₹ 84 crores
31.3.2017 ₹ 92 crores

(iv) Suppliers of other consumables and services were paid ₹ 19 crores in cash.

(v) Employees of the enterprises were paid 20 crores in cash.

(vi) Fully paid preference shares of the face value of ₹ 32 crores were redeemed. Equity shares of the face value of ₹ 20 crores were allotted as fully paid up at premium of 20%.

(vii) Debentures of ₹ 20 crores at a premium of 10% were redeemed. Debenture holders were issued equity shares in lieu of their debentures.

(viii) ₹ 26 crores were paid by way of income tax.

(ix) A new machinery costing ₹ 25 crores was purchased in part exchange of an old machinery. The book value of the old machinery was ₹ 13 crores. Through the negotiations, the vendor agreed to take over the old machinery at a higher value of ₹ 15 crores. The balance was paid in cash to the vendor.

(x) Investment costing ₹ 18 cores were sold at a loss of ₹ 2 crores.

(xi) Dividends amounting ₹ 15 crores (including dividend distribution tax of ₹ 2.7 crores) was also paid.

(xii) Debenture interest amounting ₹ 2 crore was paid.

(xiii) On 31st March 2016, Balance with Bank and Cash on hand was ₹ 2 crores.

On the basis of the above information, you are required to prepare a Cash Flow Statement for the year ended 31st March, 2017 (Using direct method).

(*RTP May 2018*)

**Answer:**

**Cash flow statement (using direct method) for the year ended 31st March, 2017**

| | **(₹ in crores)** | **(₹ in crores)** |
|---|---|---|
| **Cash flow from operating activities** | | |
| Cash sales | 262 | |
| Cash collected from credit customers | 134 | |
| Less: Cash paid to suppliers for goods & services | | |
| and to employees (Refer Working Note) | (251) | |
| Cash from operations | 145 | |
| Less: Income tax paid | (261 | |
| Net cash generated from operating activities | | 119 |
| **Cash flow from investing activities** | | |
| Net Payment for purchase of Machine (25 - 15) | (10) | |
| Proceeds from sale of investments | 16 | |
| Net cash used in investing activities | | 6 |
| **Cash flow from financing activities** | | |
| Redemption of Preference shares | (32) | |
| Proceeds from issue of Equity shares | 24 | |
| Debenture interest paid | (2) | |
| Dividend Paid | (15) | |
| **Net cash used in financing activities** | | (25) |
| Net increase in cash and cash equivalents | | 100 |
| Add: Cash and cash equivalents as on 1.04.2016 | | 2 |
| Cash and cash equivalents as on 31.3.2017 | | 102 |

**Working Note:**

**Calculation of cash paid to suppliers of goods and services and to employees**

| | **(₹ in crores)** |
|---|---:|
| Opening Balance in creditors Account | 84 |
| Add: Purchases (220 x .8) | 176 |
| Total | 260 |
| Less: Closing balance in Creditors Account | 92 |
| Cash paid to suppliers of goods | 168 |
| Add: Cash purchases (220 x .2) | 44 |
| Total cash paid for purchases to suppliers (a) | 212 |
| Add: Cash paid to suppliers of other consumables and services (b) | 19 |
| Add: Payment to employees (c) | 20 |
| Total cash paid to suppliers of goods & services and to employees [(a) + (b) + (c)] | 251 |

## Question 26

Classify the following activities as (i) Operating Activities, (ii) Investing Activities, (iii) Financing Activities:

(a) Purchase of Machinery.
(b) Proceeds from issuance of equity share capital
(c) Cash Sales.
(d) Proceeds from long-term borrowings.
(e) Proceeds from Trade receivables.
(f) Cash receipts from Trade receivables.
(g) Trading Commission received.
(h) Purchase of investment.
(i) Redemption of Preference Shares.
(j) Cash Purchases.

(*MTP October, 2018*) (*5 Marks*)

**Answer:**

(i) Operating Activities: c, e, f, g, j.
(ii) Investing Activities: a, h.
(iii) Financing Activities: b, d, i.

## Question 27

Prepare Cash Flow from Investing Activities of Creative Furnishings Limited for the year ended 31-3-2017.

| **Particulars** | **₹** |
|---|---:|
| Plant acquired by the issue of 8% Debentures | 1,56,000 |
| Claim received for loss of plant in fire | 49,600 |
| Unsecured loans given to subsidiaries | 4,85,000 |
| Interest on loan received from subsidiary companies | 82,500 |
| Pre-acquisition dividend received on investment made | 62,400 |
| Debenture interest paid | 1,16,000 |
| Term loan repaid | 4,25,000 |
| Interest received on investment | 68,000 |
| (TDS of ₹ 8.200 was deducted on the above interest) | |
| Book value of plant sold (loss incurred ₹ 9,600) | 84,000 |

(*MTP April, 2018*) (*5 Marks*)

**Answer:**

**Cash Flow Statement from Investing Activities of**
**Creative Furnishings Limited for the year ended 31-03-2017**

| **Cash generated from investing activities** | **₹** | **₹** |
|---|---:|---:|
| Interest on loan received | 82,500 | |
| Pre-acquisition dividend received on investment made | 62,400 | |
| Unsecured loans given to subsidiaries | (4,85,000) | |
| Interest received on investments (gross value) | 76,200 | |
| TDS deducted on interest | (8,200) | |
| Sale of plant | 74,400 | |
| Cash used in investing activities (before extra ordinary item) | | (1,97,700) |
| Extraordinary claim received for loss of plant | | 49,600 |
| Net cash used in investing activities (after extra ordinary item) | | (1,48,100) |

**Note:**

1. Debenture interest paid and Term Loan repaid are financing activities and therefore not considered for preparing cash flow from investing activities.
2. Plant acquired by issue of 8% debentures does not amount to cash outflow, hence also not considered in the above cash flow statement.

## Question 28

From the following information, prepare a Cash Flow Statement for the year ended 31st March, 2019.

**Balance Sheets**

| | **Particulars** | **Note** | **31.03.2019 (₹)** | **31.03.2018 (₹)** |
|---|---|---|---|---|
| I | EQUITY AND LIABILITES | | | |
| | (1) Shareholder's Funds | | | |
| | (a) Share Capital | 1 | 3,50,000 | 3,00,000 |
| | (b) Reserves and Surplus | 2 | 82,000 | 38,000 |
| | (2) Non-Current Liabilities | | | |
| | (3) Current Liabilities | | | |
| | (a) Trade Payables | | 65,000 | 44,000 |
| | (b) Other Current Liabilities | 3 | 37,000 | 27,000 |
| | (c) Short term Provisions (provision for tax) | | 32,000 | 28,000 |
| | Total | | 5,66,000 | 4,37,000 |
| II | ASSETS | | | |
| | (1) Non-current Assets | | | |
| | (a) Tangible Assets | 4 | 2,66,000 | 1,90,000 |
| | (b) Intangible Assets (Goodwill) | | 47,000 | 60,000 |
| | Non-Current Investments | | 35,000 | 10,000 |
| | (2) Current Assets | | | |
| | (a) Inventories | | 78,000 | 85,000 |
| | (b) Trade Receivables | | 1,08,000 | 75,000 |
| | (c) Cash & Cash Equivalents | | 32,000 | 17,000 |
| | Total | | 5,66,000 | 4,37,000 |

**Note 1: Share Capital**

| **Particulars** | **31.03.2019 (₹)** | **31.03.2018 (₹)** |
|---|---|---|
| Equity Share Capital | 2,50,000 | 1,50,000 |
| 8% Preference Share Capital | 1,00,000 | 1,50,000 |
| Total | 3,50,000 | 3,00,000 |

**Note 2: Reserves and Surplus**

| **Particulars** | **31.03.2019 (₹)** | **31.03.2018 (₹)** |
|---|---|---|
| General Reserve | 30,000 | 20,000 |
| Profit and Loss A/c | 27,000 | 18,000 |
| Capital Reserve | 25,000 | |
| Total | 82,000 | 38,000 |

**Note 3: Current Liabilities**

| **Particulars** | **31.03.2019(₹)** | **31.03.2018 (₹)** |
|---|---|---|
| Dividend declared | 37,000 | 27,000 |

**Note 4: Tangible Assets**

| **Particulars** | **31.03.2019 (₹)** | **31.03.2018 (₹)** |
|---|---|---|
| Land & Building | 75,000 | 1,00,000 |
| Machinery | 1,91,000 | 90,000 |
| Total | 2,66,000 | 1,90,000 |

**Additional Information:**

(i) ₹ 18,000 depreciation for the year has been written off on plant and machinery and no depreciation has been charged on Land and Building.

(ii) A piece of land has been sold out for ₹ 50,000 and the balance has been revalued, profit on such sale and revaluation being transferred to capital reserve. There is no other entry in Capital Reserve Account.

(iii) A plant was sold for ₹ 12,000 WDV being ₹ 15,000 on the date of sale (after charging depreciation).

(iv) Dividend received amounted to ₹ 2,100 which included pre-acquisition dividend of ₹ 600.

(v) An interim dividend of ₹ 10,000 including Dividend Distribution Tax has been paid.

(vi) Non-current investments given in the balance sheet represents investment in shares of other companies.

(vii) Amount of provision for tax existing on 31 3.2018 was paid during the year 2018 -19.

(*RTP November 2019*)

**Answer**

**Cash flow Statement for the year ending 31st March, 2019**

| | | *Particulars* | ₹ | ₹ |
|---|---|---|---|---|
| 1 | | **Cash Flow from Operating Activities** | | |
| | A. | Closing balance as per Profit and Loss Account | | 27,000 |
| | | *Less:* Opening balance as per Profit and Loss Account | | (18,000) |
| | | *Add:* Dividend declared during the year | | 37,000 |
| | | *Add:* Interim dividend paid during the year | | 10,000 |
| | | *Add:* Transfer to reserve | | 10,000 |
| | | *Add:* Provision for Tax | | 32,000 |
| | B. | Net profit before taxation, and extra-ordinary item | | 98,000 |
| | C. | *Add:* Items to be added | | |
| | | Depreciation | 18,000 | |
| | | Loss on sale of Plant | 3,000 | |
| | | Goodwill written off | 13,000 | 34,000 |
| | D. | *Less:* Dividend Income | | (1,500) |
| | E. | Operating profit before working capital changes [B + C - D] | | 1,30,500 |
| | F. | *Add:* Decrease in Current Assets and Increase in Current Liabilities | | |
| | | Decrease in Inventories | 7,000 | |
| | | Increase in Trade Payables | 21,000 | 28,000 |
| | G. | *Less:* Increase in Trade Receivables | | (33,000) |
| | H | Cash generated from operations (E+F-G) | | 1,25,500 |
| | I | Less: Income taxes paid | | (28,000) |
| | J | Net Cash from (used in) operating activities | | 97,500 |
| II. | | **Cash Flows from investing activities:** | | |
| | | Purchase of Plant | | (1,34,000) |
| | | Sale of Land | | 50,000 |
| | | Sale of plant | | 12,000 |
| | | Purchase of investments | | (25,600) |
| | | Dividend Received | | 2,100 |
| | | Net cash used in investing activities | | (95,500) |
| III. | | **Cash Flows from Financing Activities:** | | |
| | | Proceeds from issue of equity share capital | | 1,00,000 |
| | | Redemption of preference shares | | (50,000) |
| | | Interim Dividend (inclusive of DDT) paid | | (10,000) |
| | | Final dividend (inclusive of DDT) paid | | (27,000) |
| | | Net cash from financing activities | | 13,000 |
| IV. | | **Net increase in cash and cash equivalents (I+II+III)** | | 15,000 |
| V. | | **Cash and cash equivalents at beginning of period** | | 17,000 |
| VI. | | **Cash and cash equivalents at end of period (IV+V)** | | 32,000 |

**1. Land and Building Account**

| ***Particulars*** | ₹ | ***Particulars*** | ₹ |
|---|---|---|---|
| To Balance b/d | 1,00,000 | By Bank A/c (Sale) | 50,000 |
| To Capital Reserve A/c (Profit on sale/revaluation) | 25,000 | By Balance c/d | 75,000 |
| | 1,25,000 | | 1,25,000 |

**2. Plant and Machinery Account**

| ***Particulars*** | ₹ | ***Particulars*** | ₹ |
|---|---|---|---|
| To Balance b/d | 90,000 | By Depreciation A/c | 18,000 |
| To Bank A/c (Purchase) | 1,34,000 | By Bank A/c (sale) | 12,000 |
| | | By Profit and Loss A/c (Loss on sale) | 3,000 |
| | | By Balance c/d | 1,91,000 |
| | 2,24,000 | | 2,24,000 |

**3. Investments Account**

| ***Particulars*** | ₹ | ***Particulars*** | ₹ |
|---|---|---|---|
| To Balance b/d | 10,000 | By Bank A/c (Div. received) | 600 |
| To bank A/c (Purchase | 25,600 | By Balance c/d | 35,000 |
| | 35,600 | | 35,600 |

## Question 29

J Ltd. presents you the following information for the year ended 31st March, 2019:

| | | **(₹ in lacs)** |
|---|---|---|
| (i) | Net profit before tax provision | 36,000 |
| (ii) | Dividend paid | 10,202 |
| (iii) | Income-tax paid | 5,100 |
| (iv) | Book value of assets sold | 222 |
| | Loss on sale of asset | 48 |
| (v) | Depreciation debited to P & L account | 24,000 |
| (vi) | Capital grant received - amortized to P & L A/c | 10 |
| (vii) | Book value of investment sold | 33,318 |
| | Profit on sale of investment | 120 |
| (viii) | Interest income from investment credited to P & L A/c | 3,000 |
| (ix) | Interest expenditure debited to P & L A/c | 12,000 |
| (x) | Interest actually paid (Financing activity) | 13,042 |
| (xi) | Increase in working capital | 67,290 |
| | [Excluding cash and bank balance] | |
| (xii) | Purchase of fixed assets | 22,092 |
| (xiii) | Expenditure on construction work | 41,688 |
| (xiv) | Grant received for capital projects | 18 |
| (XV) | Long term borrowings from banks | 55,866 |
| (xvi) | Provision for Income-tax debited to P & L A/c | 6,000 |
| | Cash and bank balance on 1.4.2018 | 6,000 |
| | Cash and bank balance on 31.3.2019 | 8,000 |

You are required to prepare a cash flow statement as per AS-3 (Revised). [*MTP October, 2019, 12 marks*]

**Answer**

**Cash Flow Statement as per AS 3**

| | | **₹ in lacs** |
|---|---|---|
| Cash flows from operating activities: | | 36,000 |
| Net profit before tax provision | | |
| Add: Non cash expenditures: | | |
| Depreciation | 24,000 | |
| Loss on sale of assets | 48 | |
| Interest expenditure (non operating activity) | 12,000 | 36,048 |
| | | 72,048 |

| | | **₹ in lacs** |
|---|---|---|
| Less: Non cash income | | |
| Amortisation of capital grant received | (10) | |
| Profit on sale of investments (non operating income) | (120) | |
| Interest income from investments (non operating income) | (3,000) | 3,130 |
| Operating profit | | 68,918 |
| Less: Increase in working capital | | (67,290) |
| Cash from operations | | 1,628 |
| Less: Income tax paid | | (5,100) |
| Net cash generated from operating activities | | (3,472) |
| Cash flows from investing activities: | | |
| Sale of assets (222-48) | 174 | |
| Sale of investments (33,318+120) | 33,438 | |
| Interest income from investments | 3,000 | |
| Purchase of fixed assets | (22,092) | |
| Expenditure on construction work | (41,688) | |
| Net cash used in investing activities | | (27,168) |
| Cash flows from financing activities: | | |
| Grants for capital projects | 18 | |
| Long term borrowings | 55,866 | |
| Interest paid | (13,042) | |
| Dividend paid | (10,202) | |
| Net cash from financing activities | | 32,640 |
| Net increase in cash | | 2,000 |
| Add: Cash and bank balance as on 1.4.2018 | | 6,000 |
| Cash and bank balance as on 31.3.2019 | | 8,000 |

## Question 30

Prepare cash flow from investing activities as per AS 3 of M/s Subham Creative Limited for year ended 31.3.2019.

| Particulars | **Amount (₹)** |
|---|---|
| Machinery acquired by issue of shares at face value | 2,00,000 |
| Claim received for loss of machinery in earthquake | 55,000 |
| Unsecured loans given to associates | 5,00,000 |
| Interest on loan received form associate company | 70,000 |
| Pre-acquisition dividend received on investment made | 52,600 |
| Debenture interest paid | 1,45,200 |
| Term loan repaid | 4,50,000 |
| Interest received on investment (TDS of ₹8,200 was deducted on the above interest) | 73,800 |
| Purchased debentures of X Ltd., on 1st December, 2018 which are redeemable within 3 mouths | 3,00,000 |
| Book value of plant & machinery sold (loss incurred ₹9,600) | 90,000 |

(*November 2019*) (*5 Marks*)

**Answer**

**Cash Flow Statement from Investing Activities of**
**Subham Creative Limited for the year ended 31-03-2019**

| ***Cash generated from investing activities*** | **₹** | **₹** |
|---|---|---|
| Interest on loan received | 70,000 | |
| Pre-acquisition dividend received on investment made | 52,600 | |
| Unsecured loans given to subsidiaries | (5,00,000) | |
| Interest received on investments (gross value) | 82,000 | |
| TDS deducted on interest | (8,200) | |
| Sale of Plant & Machinery ₹ (90,000 – 9,600) | 80,400 | |
| Cash used in investing activities (before extra-ordinary item) Extraordinary claim received for loss of machinery | | (2,23,200)<br>55,000 |
| Net cash used in investing activities (after extra-ordinary item) | | (1,68,200) |

**Note:**

1. Debenture interest paid and Term Loan repaid are financing activities and therefore not considered for preparing cash flow from investing activities.
2. Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered in the above cash flow statement.
3. The investments made in debentures are for short-term, it will be treated as 'cash equivalent' and will not be considered as outflow in cash flow statement.

## Question 31

Prepare Cash Flow Statement of Light Ltd. for the year ended 31st March, 2020, in accordance with AS 3 (Revised) from the following Summary Cash Account:

**Summary Cash Account**

| | **₹ in '000** | **₹ in '000** |
|---|---|---|
| Balance as on 01.04.2019 | | 315 |
| Receipts from Customers | | 24,894 |
| Sale of Investments (Cost ₹ 1,35,000) | | 153 |
| Issue of Shares | | 2,700 |
| Sale of Fixed Assets | | 1,152 |
| Payment to Suppliers | 18,306 | 29,214 |
| Purchase of Investments | 117 | |
| Purchase of Fixed Assets | 2,070 | , |
| Wages & Salaries | 621 | |
| Selling & Administration Expenses | 1,035 | |
| Payment of Income Tax | 2,187 | |
| Payment of Dividends | 720 | |
| Repayment of Bank Loan | 2,250 | |
| Interest paid on Bank Loan | 450 | (27,756) |
| Balance as on 31.03.2020 | | 1,458 |

(*RTP, November 2020*)

**Answer**

**Light Ltd.**
**Cash Flow Statement for the year ended 31st March, 2020**

| Cash flows from operating activities | (₹ '000) | (₹ '000) |
|---|---|---|
| Cash receipts from customers | 24,894 | |
| Cash payments to suppliers | (18,306) | |
| Cash paid to employees | (621) | |
| Other cash payments (for Selling & Administrative expenses) | (1,035) | |
| Cash generated from operations | 4,932 | |
| Income taxes paid | (2,187) | |
| Net cash from operating activities | | 2,745 |
| Cash flows from investing activities | | |
| Payments for purchase of fixed asset | (2,070) | |
| Proceeds from sale of fixed assets | 1,152 | |
| Purchase of investments | (117) | |
| Sale of investments | 153 | |
| Net cash used in investing activities | | (882) |
| Cash flows from financing activities | | |
| Proceeds from issuance of share capital | 2,700 | |
| Bank loan repaid | (2,250) | |
| Interest paid on bank loan | (450) | |
| Dividend paid | (720) | |
| Net cash used in financing activities | | (720) |
| Net increase in cash and cash equivalents | | 1,143 |
| Cash and cash equivalents at beginning of period | | 315 |
| Cash and cash equivalents at end of period | | 1,458 |

## Question 32

Prepare Cash Flow Statement of Tom & Jerry Ltd. for the year ended 31stMarch, 2020, in accordance with AS-3 (Revised) from the following Summary Cash Account:

**Summary Cash Account**

| | ₹ in '000 | ₹ in'000 |
|---|---|---|
| Balance as on 01.04.2019 | | 210 |
| Receipts from Customers | | 16,596 |
| Sale of Investments (Cost ₹ 90,000) | | 102 |
| Issue of Shares | | 1,800 |
| Sale of Fixed Assets | | 768 |
| | | 19,476 |
| Payment to Suppliers | 12,204 | |
| Purchase of Investments | 78 | |
| Purchase of Fixed Assets | 1,380 | , |
| Wages & Salaries | 414 | |
| Selling & Administration Expenses | 690 | |
| Payment of Income Tax | 1,458 | |
| Payment of Dividends | 480 | |
| Repayment of Bank Loan | 1,500 | |
| Interest paid on Bank Loan | 300 | (18,504) |
| Balance as on 31.03.2020 | | 972 |

*(8 Marks) (MTP, May 2020)*

**Answer:**

**Cash Flow Statement of Tom & Jerry Ltd.**
**for the year ended 31st March, 2020**

| | | (₹ '000) |
|---|---|---|
| Cash flows from operating activities | | |
| Cash receipts from customers | 16,596 | |
| Cash payments to suppliers | (12,204) | |
| Cash paid to employees | (414) | |
| Other cash payments (for Selling & Administrative expenses) | (690) | |
| Cash generated from operations | 3,288 | |
| Income taxes paid | (1,458) | |
| Net cash from operating activities | | 1,830 |
| Cash flows from investing activities | | |
| Payments for purchase of fixed asset | (1,380) | |
| Proceeds from sale of fixed assets | 768 | |
| Purchase of investments | (78) | |
| Sale of investments | 102 | |
| Net cash used in investing activities | | (588) |
| Cash flows from financing activities | | |
| Proceeds from issue of share capital | 1,800 | |
| Bank loan repaid | (1,500) | |
| Interest paid on bank loan | (300) | |
| Dividend paid | (480) | |
| Net cash used in financing activities | | (480) |
| Net increase in cash and cash equivalents | | 762 |
| Cash and cash equivalents at beginning of period | | 210 |
| Cash and cash equivalents at end of period | | 972 |

## Question 33

What do you mean by the term "cash and cash equivalent" as per AS 3? From the following information of XYZ Limited, calculate cash and cash equivalent as on 31-03-2019.

| Particulars | Amount (₹) |
|---|---|
| Cash balance with Bank | 10,000 |
| Fixed Deposit created on 01-11-2018 and maturing on15-07-2019 | 75,000 |
| Short Term Investment in highly liquid Sovereign Debt Mutual fund made on 01-03-2019 (having maturity period of less than 3 months) | 1,00,000 |
| Bank Balance in a Foreign Currency Account in India | $ 1,000 |
| (Conversion Rate: on the day of deposit ₹ 69/USD; ₹ 70/USD as on 31-03-2019) | |
| Debentures purchased of ₹ 10 lacs of A Ltd., which are redeemable on 31st October, 2019 | 90,000 |
| Shares of Alpha Ltd. purchased on 1st January, 2019 | 60,000 |

*(MTP, October, 2020)* (*5 Marks*)

**Answer**

As per AS 3, Cash and cash equivalents consists of: (i) Cash in hand and deposits repayable on demand with any bank or other financial institutions and (ii) Cash equivalents, which are short term, highly liquid investments that are readily convertible into known amounts of cash and are subject to insignificant risk or change in value. A short-term investment is one, which is due for maturity within three months from the date of acquisition. Investments in shares are not normally taken as cash equivalent, because of uncertainties associated with them as to realizable value.

**Computation of Cash and Cash Equivalents as on 31st March, 2019**

| | ₹ |
|---|---|
| Cash balance with bank | 10,000 |
| Short term investment in highly liquid sovereign debt mutual fund on 1.3.19 | 1,00,000 |
| Bank balance in foreign currency account ($1,000 x ₹ 70) | 70,000 |
| | 1,80,000 |

**Note:** Fixed deposit, Shares and Debentures will not be considered as cash and cash equivalents.

## Question 34

Following information was extracted from the books of S Ltd. for the year ended 31st March, 2020 :

(1) Net profit before talking into account income tax and after talking into account the following items was ₹30 lakhs;
   - (i) Depreciation on Property, Plant & Equipment ₹7,00,000
   - (ii) Discount on issue of debentures written off ₹45,000.
   - (iii) Interest on debentures paid ₹4,35,000
   - (iv) Investment of Book value ₹3,50,000 sold for ₹3,75,000.
   - (v) Interest received on Investments ₹70,000

(2) Income tax paid during the year ₹ 12,80,000

(3) Company issued 60,000 Equity Shares of ₹10 each at a premium of 20% on 10th April, 2019.

(4) 20,000, 9% Preference Shares of ₹100 each were redeemed on 31st March, 2020 at a premium of 5%

(5) Dividend paid during the year amounted to ₹11 Lakhs (including dividend distribution tax)

(6) A new Plant costing ₹7 Lakhs was purchased in part exchange of an old plant on 1st January, 2020. The book value of the old plant was ₹8 Lakhs but the vendor took over the old plant at a value of ₹6 Lakhs only. The balance amount was paid to vendor through cheque on 30th March, 2020.

(7) Company decided to value inventory at cost less 10%, whereas previously the practice was to value inventory at cost. The inventory according to books on 31.03.2020 was ₹ 14,76,000.
The inventory on 31.03.2019 was correctly valued at ₹ 13,50,000.

(8) Current Assets and Current Liabilities in the beginning and at the end of year 2019-2020 were as:

| | As on 1st April, 2019 (₹) | As on 31st March, 2020 (₹) |
|---|---|---|
| Inventory | 13,50,000 | 14,76,000 |
| Trade Receivables | 3,27,000 | 3,13,200 |
| Cash &Bank Balances | 2,40,700 | 3,70,500 |
| Trade Payables | 2,84,700 | 2,87,300 |
| Outstanding Expenses | 97,000 | 1,01,400 |

You are required to prepare a Cash Flow Statement for the year ended 31st March, 2020 as per AS 3 (revised) using the indirect method. (*Suggested January 2021*) (*12 marks*)

**Answer**

**S Ltd.**
**Cash Flow Statement for the year ended 31st March, 2020**

| | ₹ | ₹ |
|---|---|---|
| Cash flows from operating activities | | |
| Net profit before taxation* | | 30,00,000 |
| Adjustments for: | | |
| Depreciation on PPE | 7,00,000 | |
| Discount on debentures | 45,000 | |
| Profit on sale of investments | (25,000) | |
| Interest income on investments | (70,000) | |
| Interest on debentures | 4,35,000 | |
| Stock adjustment | 1,64,000 | |
| {14,76,000 less 16,40,000(14,76,000/90X100)} | | |
| Operating profit before working capital changes | | 12,49,000 |
| Changes in working capital | | 42,49,000 |
| (Excluding cash and bank balance): | | |
| Less: Increase in inventory | (2,90,000) | |
| {16,40,000(14,76,000/90X100) less 13,50,000} | | |
| Add: Decrease in Trade receivables | 13,800 | |
| Increase in trade payables | 2,600 | |
| Increase in o/s expenses | 4,400 | (2,69,200) |
| Cash generated from operations | | 39,79,800 |
| Less: Income taxes paid | | (12,80,000) |
| Net cash generated from operating activities | | 26,99,800 |
| Cash flows from investing activities | | |
| Sale of investments | 3,75,000 | |
| Interest received | 70,000 | |
| Payments for purchase of fixed assets | (1,00,000) | |
| (7,00,000 – 6,00,000) | | |
| Net cash used in investing activities | | 3,45,000 |
| Cash flows from financing activities | | |
| Redemption of Preference shares | (21,00,000) | |
| Issue of shares | 7,20,000 | |
| Interest paid | (4,35,000) | |
| Dividend paid | (11,00,000) | |
| Net cash used in financing activities | | (29,15,000) |
| Net increase in cash | | 1,29,800 |
| Cash at beginning of the period | | 2,40,700 |
| Cash at end of the period | | 3,70,500 |

*Net profit given in the question is after considering only the items listed as information point (1) of the question; hence amount of loss on plant not added back.

## Similar Question

**Question 34A**

The following information is provided by Alpha Limited, for the year ended 31st March, 2022.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 40 lakhs.

(ii) Depreciation on Fixed Assets ₹ 10 lakhs.

(iii) Discount on issue of Debentures written off ₹ 60,000.

(iv) Interest on Debentures paid ₹ 7,00,000.

(v) Book value of investments ₹ 6 lakhs (Sale of Investments for ₹ 6,40,000).

(vi) Interest received on investments ₹ 1,20,000.

(vii) Compensation received ₹ 1,80,000 by the company in a suit filed.

(viii) Income tax paid ₹ 21,00,000

(ix) Current assets and current liabilities in the beginning and at the end of the year were as detailed below:

| | As on 31.3.2021 ₹ | As on 31.3.2022 ₹ |
|---|---:|---:|
| Stock | 24,00,000 | 26,36,000 |
| Sundry Debtors | 4,16,000 | 4,26,200 |
| Cash in hand | 3,92,600 | 70,600 |
| Bills Receivable | 1,00,000 | 80,000 |
| Bills Payable | 90,000 | 80,000 |
| Sundry Creditors | 3,32,000 | 3,42,600 |
| Outstanding Expenses | 1,50,000 | 1,63,600 |

You are required to prepare Cash Flow Statement from Operative Activities in accordance with AS-3 (revised) using the indirect method for the year ended 31st March, 2022

(*Question Paper, May 2022*) (*4 Marks*)

## Question 35

Prepare cash flow from investing activities as per AS 3 of M/s Subham Creative Limited for year ended 31.3.2019.

| Particulars | Amount (₹) |
|---|---:|
| Machinery acquired by issue of shares at face value | 2,00,000 |
| Claim received for loss of machinery in earthquake | 55,000 |
| Unsecured loans given to associates | 5,00,000 |
| Interest on loan received from associate company | 70,000 |
| Pre-acquisition dividend received on investment made | 52,600 |
| Debenture interest paid | 1,45,200 |
| Term loan repaid | 4,50,000 |
| Interest received on investment (TDS of ₹ 8,200 was deducted on the above interest) | 73,800 |
| Book value of plant & machinery sold (loss incurred ₹ 9,600) | 90,000 |

(*MTP March, 2021*) (*MTP April, 2022*) (*4 Marks*)

**Answer**

**Cash Flow Statement from Investing Activities of Subham Creative Limited for year ended 31-03-2019**

| ***Cash generated from investing activities*** | ₹ | ₹ |
|---|---:|---:|
| Interest on loan received | 70,000 | |
| Pre-acquisition dividend received on investment made | 52,600 | |
| Unsecured loans given to subsidiaries | (5,00,000) | |
| Interest received on investments (gross value) | 82,000 | |
| TDS deducted on interest | (8,200) | |
| Sale of Plant & Machinery ₹ (90,000 – 9,600) | 80,400 | |
| | | (2,23,200) |
| Cash used in investing activities (before extra-ordinary item) | | 55,000 |
| Extraordinary claim received for loss of machinery | | |
| Net cash used in investing activities (after extra-ordinary item) | | (1,68,200) |

Note:

1. Debenture interest paid and Term Loan repaid are financing activities and therefore not considered for preparing cash flow from investing activities.
2. Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered in the above cash flow statement.

## Question 36

Following is the cash flow abstract of Alpha Ltd. for the year ended 31st March, 2021:

**Cash Flow (Abstract)**

| Inflows | ₹ | Outflows | ₹ |
|---|---:|---|---:|
| Opening cash and bank balance | 80,000 | Payment for Account Payables | 90,000 |
| Share capital – shares issued | 5,00,000 | Salaries and wages | 25,000 |
| Collection from Trade | | Payment of overheads | 15,000 |
| Receivables | 3,50,000 | Machinery acquired | 4,00,000 |
| | | Debentures redeemed | 50,000 |
| Sale of Machinery | 70,000 | Bank loan repaid | 2,50,000 |
| | | Tax paid | 1,55,000 |
| | | Closing cash and bank balance | 15,000 |
| | 10,00,000 | | 10,00,000 |

Prepare Cash Flow Statement for the year ended 31st March, 2021 in accordance with AS 3.

(*MTP April, 2021*) (*MTP March 2022*) (*5 Marks*)

**Answer**

**Cash Flow Statement for the year ended 31.3.2021**

| | ₹ | ₹ |
|---|---|---|
| **Cash flow from operating activities** | | |
| Cash received on account of trade receivables | 3,50,000 | |
| Cash paid on account of trade payables | (90,000) | |
| Cash paid to employees (salaries and wages) | (25,000) | |
| Other cash payments (overheads) | (15,000) | |
| Cash generated from operations | 2,20,000 | |
| Income tax paid | (1,55,000) | |
| Net cash generated from operating activities | | 65,000 |
| **Cash flow from investing activities** | | |
| Payment for purchase of machinery | (4,00,000) | |
| Proceeds from sale of machinery | 70,000 | |
| Net cash used in investment activities | | (3,30,000) |
| **Cash flow from financing activities** | | |
| Proceeds from issue of share capital | 5,00,000 | |
| Bank loan repaid | (2,50,000) | |
| Debentures redeemed | (50,000) | |
| Net cash used in financing activities | | 2,00,000 |
| Net decrease in cash and cash equivalents | | (65,000) |
| Cash and cash equivalents at the beginning of the year | | 80,000 |
| Cash and cash equivalents at the end of the year | | 15,000 |

## Question 37

Prepare cash flow statement of Gama Limited for the year ended 31st March, 2021 in accordance with AS-3 (Revised) from the following cash account summary:

**Cash Summary Account**

| Inflows | ₹('000) | Outflows | ₹('000) |
|---|---|---|---|
| Opening Balance | 945 | Payment to suppliers | 54,918 |
| Receipts from Customers | 74,682 | Purchase of Investments | 351 |
| Sale of Investment (Cost ₹4,05,000) | 459 | Property, plant and equipment acquired | 6,210 |
| Issue of Shares | 8,100 | Wages and salaries | 1,863 |
| Sale of Property, Plant and equipment | 3,456 | Payment of Overheads | 3,105 |
| | | Taxation | 6,561 |
| | | Dividends | 2,160 |
| | | Repayment of Bank Overdraft | 6,750 |
| | | Interest paid on Bank Overdraft | 1,350 |
| | | Closing Balance | 4,374 |
| | **87,642** | | **87,642** |

(*Question Paper July 2021*) (*5 Marks*)

**Answer**

**Gama Limited**

**Cash Flow Statement**

**For the Year Ended 31st March 2021**

| Particulars | Amount (₹'000) | Amount (₹'000) |
|---|---|---|
| **Cash flow from Operating Activities:** | | |
| Cash receipts from customers | 74,682 | |
| Cash payments to suppliers | (54,918) | |
| Cash payments for wages & salaries | (1,863) | |

| Particulars | Amount (₹'000) | Amount (₹'000) |
|---|---|---|
| Cash payments of overheads | (3,105) | |
| Cash Generated from Operations | 14,796 | |
| Payment of Taxation | (6,561) | |
| **Net Cash from Operating Activities** | | 8,235 |
| **Cash Flow from Investing Activities:** | | |
| Proceeds from sale of investments | 459 | |
| Proceeds from sale of Property, Plant and Equipment | 3,456 | |
| Purchase of Investments | (351) | |
| Purchase of Property, Plant and Equipment | (6,210) | |
| **Net Cash Used in Investing Activities** | | (2,646) |
| **Cash Flow from Financing Activities:** | | |
| Proceeds from issue of shares | 8,100 | |
| Payment of Dividend | (2,160) | |
| Repayment of Bank Overdraft | (6,750) | |
| Interest paid on Bank Overdraft | (1,350) | |
| **Net Cash Used in Financing Activities** | | (2,160) |
| **Net Increase in Cash & Cash Equivalent** | | 3,429 |
| **Cash and Cash Equivalent in the Beginning of the year** | | 945 |
| **Cash and Cash Equivalent in the end of the year** | | 4374 |

## Question 38

The following are the extracts of Balance Sheet and Statement of Profit and Loss of Supriya Ltd.:

### Extract of Balance Sheet

| | | *Particulars* | *Notes* | *2021 (₹000)* | *2020 (₹000)* |
|---|---|---|---|---|---|
| | | **Equity and Liabilities** | | | |
| 1 | | **Shareholder's funds** | | | |
| | (a) | Share capital | 1 | 500 | 200 |
| 2 | | **Non- current liabilities** | | | |
| | (a) | Long term loan from bank | | --- | 250 |
| 3 | | **Current liabilities** | | | |
| | (a) | Trade Payables | | 1,000 | 3,047 |
| | | **Assets** | | | |
| 1 | | **Non-current assets** | | | |
| | (a) | Property, Plant and Equipment | | 230 | 128 |
| 2 | | **Current assets** | | | |
| | (a) | Trade receivables | | 2,000 | 4,783 |
| | (b) | Cash & cash equivalents (Cash balance) | | 212 | 35 |

**Extract of Statement of Profit and Loss**

| | *Particulars* | *Notes* | *2021 (₹000)* | *2020 (₹000)* |
|---|---|---|---|---|
| I | Expenses: | | | |
| | Employee benefits expense | | 69 | 25 |
| | Other expenses | 2 | 115 | 110 |
| II | Tax expense: | | | |
| | Current tax (paid during year) | | 243 | 140 |

**Notes to accounts**

| | | *2021 (₹000)* | *2020 (₹000)* |
|---|---|---|---|
| 1 | **Share Capital** | | |
| | Equity Shares of ₹10 each, fully paid up | 500 | 200 |
| 2 | **Other expenses** | | |
| | Overheads | 115 | 110 |

Prepare Cash Flow Statement of Supriya Ltd. for the year ended 31st March, 2021 in accordance with AS-3 (Revised) using direct method. All transactions were done in cash only. There were no outstanding/prepaid expenses as on 31st March, 2020 and on 31st March, 2021. Ignore deprecation. Dividend amounting ₹ 80,000 was paid during the year ended 31st March, 2021. (*RTP May 2021*)

## Answer

**Supriya Ltd.**
**Cash Flow Statement for the year ended 31st March, 2021**
**(Using direct method)**

| | | **(₹ '000)** |
|---|---|---|
| **Cash flows from operating activities** | | |
| Cash receipts from customers | 2,783 | |
| Cash payments to suppliers | (2,047) | |
| Cash paid to employees | (69) | |
| Other cash payments (for overheads) | (115) | |
| Cash generated from operations | 552 | |
| Income taxes paid | (243) | |
| *Net cash from operating activities* | | 309 |
| **Cash flows from investing activities** | | |
| Payments for purchase of Property, Plant and Equipment | (102) | |
| *Net cash used in investing activities* | | (102) |
| **Cash flows from financing activities** | | |
| Proceeds from issuance of share capital | 300 | |
| Bank loan repaid | (250) | |
| Dividend paid | (80) | |
| *Net cash used in financing activities* | | (30) |
| **Net increase in cash and cash equivalents** | | 177 |
| **Cash and cash equivalents at beginning of period** | | 35 |
| **Cash and cash equivalents at end of period** | | 212 |

## Question 39

The following figures have been extracted from the books of Manan Jo Limited for the year ended on 31.3.2020. You are required to prepare the Cash Flow statement as per AS 3 using indirect method.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 30 lakhs:
  (a) Depreciation on Property, Plant & Equipment ₹ 7.50 lakhs.
  (b) Discount on issue of Debentures written off ₹ 45,000.
  (c) Interest on Debentures paid ₹ 5,25,000.
  (d) Book value of investments ₹ 4.50 lakhs (Sale of Investments for ₹ 4,80,000).
  (e) Interest received on investments ₹ 90,000.

(ii) Compensation received ₹1,35,000 by the company in a suit filed.

(iii) Income-tax paid during the year ₹ 15,75,000.

(iv) 22,500, 10% preference shares of ₹ 100 each were redeemed on 02-04-2019 at a premium of 5%.

(v) Further the company issued 75,000 equity shares of ₹10 each at a premium of 20% on 30.3.2020 (Out of 75,000 equity shares, 25,000 equity shares were issued to a supplier of machinery)

(vi) Dividend for FY 2018-19 on preference shares were paid at the time of redemption.

(vii) Dividend on Equity shares paid on 31.01.2020 for the year 2018-2019 ₹ 7.50 lakhs (including dividend distribution tax) and interim dividend paid ₹ 2.50 lakhs for the year 2019-2020.

(viii) Land was purchased on 02.4.2019 for ₹3,00,000 for which the company issued 22,000 equity shares of ₹ 10 each at a premium of 20% to the land owner and balance in cash as consideration.

(ix) Current assets and current liabilities in the beginning and at the end of the years were as detailed below :

| | **As on 01.04.2019** | **As on 31.3.2020** |
|---|---|---|
| | **₹** | **₹** |
| Inventory | 18,00,000 | 19,77,000 |
| Trade receivables | 3,87,000 | 3,79,650 |
| Cash in hand | 3,94,450 | 16,950 |
| Trade payables | 3,16,500 | 3,16,950 |
| Outstanding expenses | 1,12,500 | 1,22,700 |

*(10 Marks) (November 2020)*

**Answer**

**Manan Ltd.**
**Cash Flow Statement**
**for the year ended 31st March, 2020**

| | ₹ | ₹ |
|---|---|---|
| Cash flow from Operating Activities | | |
| Net profit before income tax and extraordinary items: | | 30,00,000 |
| Adjustments for: | | |
| Depreciation on Property, plant and equipment | 7,50,000 | |
| Discount on issue of debentures | 45,000 | |
| Interest on debentures paid | 5,25,000 | |
| Interest on investments received | (90,000) | |
| Profit on sale of investments | (30,000) | 12,00,000 |
| Operating profit before working capital changes | | 42,00,000 |
| Adjustments for: | | |
| Increase in inventory | (1,77,000) | |
| Decrease in trade receivable | 7,350 | |
| Increase in trade payables | 450 | |
| Increase in outstanding expenses | 10,200 | (1,59,000) |
| Cash generated from operations | | 40,41,000 |
| Income tax paid | | (15,75,000) |
| Cash flow from ordinary items | | 24,66,000 |
| Cash flow from extraordinary items: | | |
| Compensation received in a suit filed | | 1,35,000 |
| Net cash flow from operating activities | | 26,01,000 |
| Cash flow from Investing Activities; | | |
| Sale proceeds of investments | 4,80,000 | |
| Interest received on investments | 90,000 | |
| Purchase of land (3,00,000 less 2,64,000) | (36,000) | |
| Net cash flow from investing activities | | 5,34,000 |
| Cash flow from Financing Activities | | |
| Proceeds of issue of equity shares at 20% premium | 6,00,000 | |
| Redemption of preference shares at 5% premium | (23,62,500) | |
| Preference dividend paid | (2,25,000) | |
| Interest on debentures paid | (5,25,000) | |
| Dividend paid (7,50,000 + 2,50,000) | (10,00,000) | |
| Net cash used in financing activities | | (35,12,500) |
| Net decrease in cash and cash equivalents during the year | | (3,77,500) |
| *Add*: Cash and cash equivalents as on 31.3.2019 | | 3,94,450 |
| Cash and cash equivalents as on 31.3.2020 | | 16,950 |

## Question 40

The following figures have been extracted from the books of X Limited for the year ended on 31.3.2019. You are required to prepare a cash flow statement as per AS 3 using indirect method.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 20 lakhs:

(a) Depreciation on Property, Plant & Equipment ₹ 5 lakhs.

(b) Discount on issue of Debentures written off ₹ 30,000.

(c) Interest on Debentures paid ₹ 3,50,000.

(d) Book value of investments ₹ 3 lakhs (Sale of Investments for ₹ 3,20,000).

(e) Interest received on investments ₹ 60,000.

(f) Compensation received ₹ 90,000 by the company in a suit filed.

(ii) Income tax paid during the year ₹ 10,50,000.

(iii) 15,000, 10% preference shares of ₹ 100 each were redeemed on 31.3.2019 at a premium of 5%. Further the company issued 50,000 equity shares of ₹ 10 each at a premium of 20% on 2.4.2018. Dividend on preference shares were paid at the time of redemption.

(iv) Dividend paid for the year 2017-2018 ₹ 5 lakhs and interim dividend paid ₹ 3 lakhs for the year 2018-2019.

(v) Land was purchased on 2 4.2018 for ₹ 2,40,000 for which the company issued 20,000 equity shares of ₹ 10 each at a premium of 20% to the land owner as consideration.

(vi) Current assets and current liabilities in the beginning and at the end of the years were as detailed below:

| | As on 31.3.2018 | As on 31.3.2019 |
|---|---|---|
| | ₹ | ₹ |
| Inventory | 12,00,000 | 13,18,000 |
| Trade receivables | 2,58,000 | 2,53100 |
| Cash in hand | 1,96,300 | 35,300 |
| Trade payables | 2,11,000 | 2,11,300 |
| Outstanding expenses | 75,000 | 81,800 |

(*RTP May 2020*)

**Answer**

## X Ltd.

### Cash Flow Statement

### for the year ended 31st March, 2019

| | ₹ | ₹ |
|---|---|---|
| **Cash flow from Operating Activities** | | |
| Net profit before income tax and extraordinary items: | | 20,00,000 |
| Adjustments for: | | |
| Depreciation on PPE | 5,00,000 | |
| Discount on issue of debentures | 30,000 | |
| Interest on debentures paid | 3,50,000 | |
| Interest on investments received | (60,000) | |
| Profit on sale of investments | (20,000) | 8,00,000 |
| Operating profit before working capital changes | | 28,00,000 |
| Adjustments for: | | |
| Increase in inventory | (1,18,000) | |
| Decrease in trade receivable | 4,900 | |
| Increase in trade payables | 300 | |
| Increase in outstanding expenses | 6,800 | (1,06,000) |
| Cash generated from operations | | 26,94,000 |
| Income tax paid | | (10,50,000) |
| Cash flow from extraordinary items: | | 16,44,000 |
| Compensation received in a suit filed | | 90,000 |
| Net cash flow from operating activities | | 17,34,000 |
| **Cash flow from Investing Activities** | | |
| Sale proceeds of investments | 3,20,000 | |
| Interest received on investments | 60,000 | |
| Net cash flow from investing activities | | 3,80,000 |
| **Cash flow from Financing Activities** | | |
| Proceeds by issue of equity shares at 20% premium | 6,00,000 | |
| Redemption of preference shares at 5% premium | (15,75,000) | |
| Preference dividend paid | (1,50,000) | |
| Interest on debentures paid | (3,50,000) | |
| Dividend paid (5,00,000 + 3,00,000) | (8,00,000) | |
| Net cash used in financing activities | | (22,75,000) |
| Net decrease in cash and cash equivalents during the year | | (1,61,000) |
| *Add*: Cash and cash equivalents as on 31.3.2018 | | 1,96,300 |
| Cash and cash equivalents as on 31.3.2019 | | 35,300 |

**Note:** Purchase of land in exchange of equity shares (issued at 20% premium) has not been considered in the cash flow statement as it does not involve any cash transaction.

## Question 41

From the following information, prepare the Cash Flow from Financing activities as per AS 3 'Cash Flow Statements' as the accountant of XYZ Limited is not able to decide and seeks your advice:

(i) Received ₹ 4,00,000 as redemption of short -term deposit

(ii) Proceeds of ₹ 20,00,000 from issuance of equity share capital

(iii) Received interest of ₹ 70,000 on Govt. bonds.

(iv) An amount of ₹ 13,00,000 incurred for purchase of goodwill

(v) Proceeds of ₹ 5,00,000 from sale of patent.

(vi) Proceeds of ₹ 12,00,000 from long term borrowing.

(vii) Amount paid for redemption of debentures of ₹ 22,00,000

(viii) Underwriting commission of ₹ 40,000 paid on issue of equity share capital

(ix) Interest of ₹ 1,44,000 paid on long-term borrowing.

*(MTP, October 2021) (5 Marks)*

**Answer**

**Statement showing Cash Flow from Financing Activities**

| | | ₹ |
|---|---|---|
| Cash inflow from financing activity | | |
| Proceeds from issuance of equity share capital | 20,00,000 | |
| Proceeds from long term borrowings | 12,00,000 | |
| Total cash inflow from financing activity | | 32,00,000 |
| *Less:* Cash outflow from financing activity | | |
| Amount paid for redemption of debentures | 22,00,000 | |
| Underwriting commission paid | 40,000 | |
| Interest paid on long-term borrowings | 1,44,000 | (23,84,000) |
| Net cash inflow from financing activity | | 8,16,000 |

## Question 42

The following figures have been extracted from the books of Manan Limited for the year ended on 31.3.2020. You are required to prepare the Cash Flow statement as per AS 3 using indirect method.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was ₹ 30 lakhs :

(a) Depreciation on Property, Plant & Equipment ₹ 7.50 lakhs.

(b) Discount on issue of Debentures written off ₹ 45,000.

(c) Interest on Debentures paid ₹ 5,25,000.

(d) Book value of investments ₹ 4.50 lakhs (Sale of Investments for ₹ 4,80,000).

(e) Interest received on investments ₹ 90,000.

(ii) Compensation received ₹1,35,000 by the company in a suit filed.

(iii) Income-tax paid during the year ₹ 15,75,000.

(iv) 22,500, 10% preference shares of ₹ 100 each were redeemed on 02-04-2019 at a premium of 5%.

(v) Further the company issued 75,000 equity shares of ₹10 each at a premium of 20% on 30.3.2020 (Out of 75,000 equity shares, 25,000 equity shares were issued to a supplier of machinery)

(vi) Dividend for FY 2018-19 on preference shares were paid at the time of redemption.

(vii) Dividend on Equity shares paid on 31.01.2020 for the year 2018-2019 ₹ 7.50 lakhs and interim dividend paid ₹ 2.50 lakhs for the year 2019-2020.

(viii) Land was purchased on 02.4.2019 for ₹3,00,000 for which the company issued 22,000 equity shares of ₹ 10 each at a premium of 20% to the land owner and balance in cash as consideration.

(ix) Current assets and current liabilities in the beginning and at the end of the years were as detailed below:

| | As on 01.04.2019 | As on 31.3.2020 |
|---|---|---|
| | ₹ | ₹ |
| Inventory | 18,00,000 | 19,77,000 |
| Trade receivables | 3,87,000 | 3,79,650 |
| Cash in hand | 3,94,450 | 16,950 |
| Trade payables | 3,16,500 | 3,16,950 |
| Outstanding expenses | 1,12,500 | 1,22,700 |

(*MTP, November, 2021*) (*10 Marks*)

**Answer**

**Manan Ltd.**
**Cash Flow Statement**
**for the year ended 31st March, 2020**

| | ₹ | ₹ |
|---|---|---|
| Cash flow from Operating Activities | | |
| Net profit before income tax and extraordinary items: | | 30,00,000 |
| Adjustments for: | | |
| Depreciation on Property, plant and equipment | 7,50,000 | |
| Discount on issue of debentures | 45,000 | |
| Interest on debentures paid | 5,25,000 | |
| Interest on investments received | (90,000) | |
| Profit on sale of investments | (30,000) | 12,00,000 |
| Operating profit before working capital changes | | 42,00,000 |
| Adjustments for: | | |
| Increase in inventory | (1,77,000) | |
| Decrease in trade receivable | 7,350 | |
| Increase in trade payables | 450 | |
| Increase in outstanding expenses | 10,200 | (1,59,000) |
| Cash generated from operations | | 40,41,000 |
| Income tax paid | | (15,75,000) |
| Cash flow from ordinary items | | 24,66,000 |
| Cash flow from extraordinary items: | | |
| Compensation received in a suit filed | | 1,35,000 |
| Net cash flow from operating activities | | 26,01,000 |
| Cash flow from Investing Activities; | | |
| Sale proceeds of investments | 4,80,000 | |
| Interest received on investments | 90,000 | |
| Purchase of land (3,00,000 less 2,64,000) | (36,000) | |
| Net cash flow from investing activities | | 5,34,000 |
| Cash flow from Financing Activities | | |
| Proceeds of issue of equity shares at 20% premium | 6,00,000 | |
| Redemption of preference shares at 5% premium | (23,62,500) | |
| Preference dividend paid | (2,25,000) | |
| Interest on debentures paid | (5,25,000) | |
| Dividend paid (7,50,000 + 2,50,000) | (10,00,000) | |
| Net cash used in financing activities | | (35,12,500) |
| Net decrease in cash and cash equivalents during the year | | (3,77,500) |
| *Add*: Cash and cash equivalents as on 31.3.2019 | | 3,94,450 |
| Cash and cash equivalents as on 31.3.2020 | | 16,950 |

## Question 43

On the basis of the following information prepare a Cash Flow Statement for the year ended 31st March, 2021 (Using direct method):

(i) Total sales for the year were ₹ 597 crores out of which cash sales amounted to ₹ 393 crores.

(ii) Receipts from credit customers during the year, totalled ₹ 201 crores.

(iii) Purchases for the year amounted to ₹ 330 crores out of which credit purchases were 80%.
Balance in creditors as on
1.4.2020 ₹ 126 crores
31.3.2021 ₹ 138 crores

(iv) Suppliers of other consumables and services were paid ₹ 28.5 crores in cash.

(v) Employees of the enterprises were paid 30 crores in cash.

(vi) Fully paid preference shares of the face value of ₹ 48 crores were redeemed. Equity shares of the face value of ₹ 30 crores were allotted as fully paid up at premium of 20%.

(vii) Debentures of ₹ 30 crores at a premium of 10% were redeemed. Debenture holders were issued equity shares in lieu of their debentures.

(viii) ₹ 39 crores were paid by way of income tax.

(ix) A new machinery costing ₹ 15 was purchased.

(x) Investment costing ₹ 27 cores were sold at a loss of ₹ 3 crores.

(xi) Dividends totalling ₹ 22.5 crores was also paid.

(xii) Debenture interest amounting ₹ 3 crore was paid.

(xiii) On 31st March 2020, Balance with Bank and Cash on hand totalled ₹ 3 crores.

(*RTP, November 2021*)

**Answer**

**Cash flow statement (using direct method) for the year ended 31st March, 2021**

| | **(₹ *in crores*)** | **(₹ *in crores*)** |
|---|---|---|
| **Cash flow from operating activities** | | |
| Cash sales | 393 | |
| Cash collected from credit customers | 201 | |
| *Less:* Cash paid to suppliers for goods & services and to employees (Refer Working Note) | (376.5) | |
| Cash from operations | 217.5 | |
| *Less:* Income tax paid | (39) | |
| Net cash generated from operating activities | | 178.5 |
| **Cash flow from investing activities** | | |
| Payment for purchase of Machine | (15) | |
| Proceeds from sale of investments | 24 | |
| Net cash used in investing activities | | 9 |
| **Cash flow from financing activities** | | |
| Redemption of Preference shares | (48) | |
| Proceeds from issue of Equity shares | 36 | |
| Debenture interest paid | (3) | |
| Dividend Paid | (22.5) | |
| Net cash used in financing activities | | (37.5) |
| Net increase in cash and cash equivalents | | 150 |
| *Add:* Cash and cash equivalents as on 1.04.2020 | | 3 |
| Cash and cash equivalents as on 31.3.2021 | | 153 |

**Working Note:**

**Calculation of cash paid to suppliers of goods and services and to employees**

| | **(₹ *in crores*)** |
|---|---|
| Opening Balance in creditors Account | 126 |
| *Add:* Purchases (330x .8) | 264 |
| Total | 390 |
| *Less:* Closing balance in Creditors Account | 138 |
| Cash paid to suppliers of goods | 252 |
| *Add:* Cash purchases (330x .2) | 66 |
| Total cash paid for purchases to suppliers (a) | 318 |
| *Add:* Cash paid to suppliers of other consumables and services (b) | 28.5 |
| *Add:* Payment to employees (c) | 30 |
| Total cash paid to suppliers of goods & services and to employees [(a)+ (b) + (c)] | 376.5 |

## Question 44

Following are the extracts from the Balance Sheet of ABC Ltd.

| **Liabilities** | **31.3.2020** | **31.3.2021** |
|---|---|---|
| Equity Share Capital | 25,00,000 | 35,60,000 |
| 10% Preference Share Capital | 7,00,000 | 6,00,000 |
| Securities Premium Account | 5,00,000 | 5,50,000 |
| Profit & Loss A/c | 20,00,000 | 28,00,000 |

Equity Share Capital for the year ended 31st March, 2021 'includes ₹ 60,000 of equity shares issued to Grey Ltd at par for supply of Machinery of ₹ 60,000.

Profit & Loss account on 31st March, 2021 includes ₹50,000 of dividend received on Equity shares invested in X Ltd Show how the related items will appear in the Cash Flow Statement of ABC Ltd. as per AS-3 (Revised)

(*Suggested December 2021*) (*5 Marks*)

**Answer**

The related items given in the question will appear in the Cash Flow Statement of ABC Limited for the year ended 31st March, 2021 as follows:

| | ₹ | ₹ |
|---|---|---|
| Cash flows from operating activities | | |
| Closing Balance as per Profit and Loss Account | 28,00,000 | |
| Less: Opening Balance as per Profit and Loss Account | (20,00,000) | |
| | 8,00,000 | |
| Less: Dividend received | 50,000 | |
| | | 7,50,000 |
| Cash flows from investing activities | | |
| Dividend received | | 50,000 |
| Cash flows from financing activities | | |
| Proceeds from issuance of share capital<br>Equity shares issued for cash ₹ 10,00,000<br>Proceeds from securities premium<br>(₹ 5,50,000 – 5,00,000) ₹ 50,000 | 10,50,000 | |
| Less: Redemption of Preference shares<br>(₹ 7,00,000 – ₹ 6,00,000) | (1,00,000) | 9,50,000 |

**Note:**

1. Machinery acquired by issue of shares does not amount to cash outflow, hence also not considered in the cash flow statement.
2. ABC Ltd. has been considered as a non-financial company in the given answer.

CHAPTER 5

# Applicability of Accounting Standards

## Question 1

*M/s Omega & Co. (a partnership firm), had a turnover of ₹ 1.25 crores (excluding other income) and borrowings of ₹ 0.95 crores in the previous year. It wants to avail the exemptions available in application of Accounting Standards to non-corporate entities for the year ended 31.3.20X1. Advise the management of M/s Omega & Co in respect of the exemptions of provisions of ASs, as per the directive issued by the ICAI.*

(*Source: Example 1, Study Material*)

**Answer**

The question deals with the issue of Applicability of Accounting Standards to a non- corporate entity. For availment of the exemptions, first of all, it has to be seen that M/s Omega & Co. falls in which level of the non-corporate entities. Its classification will be done on the basis of the classification of non-corporate entities as prescribed by the ICAI. According to the ICAI, non-corporate entities can be classified under 4 levels viz Level I, Level II, Level III and Level IV entities.

Non-corporate entities which meet following criteria are classified as Level IV entities:

(i) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) does not exceed rupees ten crores in the immediately preceding accounting year.

(ii) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) does not exceed rupees two crores at any time during the immediately preceding accounting year.

(iii) Holding and subsidiary entities of any one of the above.

As the turnover of M/s Omega & Co. is less than ₹ 10 crores and borrowings less than ₹ 2 crores, it falls under Level IV non-corporate entities. In this case, AS 3, AS 14, AS 17, AS 18, AS 20, AS 21, AS 23, AS 24, AS 25, AS 27 and AS 28 will not be applicable to M/s Omega & Co. Relaxations from certain requirements in respect of AS 10, AS 11, AS 13, AS 15, AS 19, AS 22, AS 26 and AS 29 are also available to M/s Omega & Co.

## Question 2

*What are the issues, with which Accounting Standards deal?*

(*Source: Question 6, Study Material*)

**Answer**

Accounting Standards deal with the issues of (i) Recognition of events and transactions in the financial statements, (ii) Measurement of these transactions and events, (iii) Presentation of these transactions and events in the financial statements in a manner that is meaningful and understandable to the reader, and (iv) Disclosure requirements.

## Question 3

*List the criteria to be applied for rating a non-corporate entity as Level-I entity and Level II entity for the purpose of compliance of Accounting Standards in India.*

(*Source: Question 7, Study Material*)

**Answer**

Refer para 1.2.1 for Criteria to be applied for rating a non-corporate entity as Level-I entity and Level II entity for the purpose of compliance of Accounting Standards in India.

## Question 4

*List the criteria to be applied for rating a non-corporate entity as Level IV entity for the purpose of compliance of Accounting Standards in India.*

(*Source: Question 8, Study Material*)

**Answer**

Refer para 1.2.1 for Criteria to be applied for rating a non-corporate entity as Level IV entity for the purpose of compliance of Accounting Standards in India.

## Question 5

*XYZ Ltd., with a turnover of ₹ 50 crores during previous year and borrowings of ₹ 1 crore during any time in the previous year, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3.20X1. Advise the management on the exemptions that are available as per the Companies (Accounting Standards) Rules, 2021.*

(*Source: Question 9, Study Material*)

**Answer**

The question deals with the issue of Applicability of Accounting Standards for corporate entities.

The companies can be classified under two categories viz SMCs and Non SMCs under the Companies (Accounting Standards) Rules, 2021.

As per the Companies (Accounting Standards) Rules, 2021, criteria for above classification as SMCs, are:

"Small and Medium Sized Company" (SMC) means, a company-

- whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;
- which is not a bank, financial institution or an insurance company;
- whose turnover (excluding other income) does not exceed rupees two- fifty crores in the immediately preceding accounting year;
- which does not have borrowings (including public deposits) in excess of rupees fifty crores at any time during the immediately preceding accounting year; and
- which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Since, XYZ Ltd.'s turnover was ₹ 50 crores which does not exceed ₹ 250 crores and borrowings of ₹ 1 crore are less than ₹ 50 crores, it is a small and medium sized company (SMC).

## Question 6

*A company was classified as Non-SMC in 20X1-X2. In 20X2-X3, it has been classified as SMC. The management desires to avail the exemptions or relaxations available for SMCs in 20X2-X3. However, the accountant of the company does not agree with the same. Comment.*

(*Source: Question 10, Study Material*)

**Answer**

As per Companies (Accounting Standards) Rules, 2021, an existing company, which was previously not a SMC and subsequently becomes a SMC, should not be qualified for exemption or relaxation in respect of accounting standards available to a SMC until the company remains a SMC for two consecutive accounting periods. Therefore, the management of the company cannot avail the exemptions/relaxations available to the SMCs for the FY 20X2-X3.

CHAPTER

# 6

# Accounting Standard 17 Segment Reporting

## Question 1

*The Chief Accountant of Sports Ltd. gives the following data regarding its six segments:*

***₹ in lakhs***

| *Particulars* | *M* | *N* | *O* | *P* | *Q* | *R* | *Total* |
|---|---|---|---|---|---|---|---|
| *Segment Assets* | *40* | *80* | *30* | *20* | *20* | *10* | *200* |
| *Segment Results* | *50* | *(190)* | *10* | *10* | *(10)* | *30* | *(100)* |
| *Segment Revenue* | *300* | *620* | *80* | *60* | *80* | *60* | *1,200* |

*The Chief accountant is of the opinion that segments "M" and "N" alone should be reported. Is he justified in his view? Discuss.*

(*Source: Illustration 1, Study Material*)

**Answer**

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or

Its segment result whether profit or loss is 10% or more of:

- The combined result of all segments in profit; or
- The combined result of all segments in loss, whichever is greater in absolute amount; or

Its segment assets are 10% or more of the total assets of all segments.

If the total external revenue attributable to reportable segments constitutes less than 75% of total enterprise revenue, additional segments should be identified as reportable segments even if they do not meet the 10% thresholds until atleast 75% of total enterprise revenue is included in reportable segments.

On the basis of turnover criteria segments M and N are reportable segments.

On the basis of the result criteria, segments M, N and R are reportable segments (since their results in absolute amount is 10% or more of₹200 lakhs).

On the basis of asset criteria, all segments except R are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reported in accordance with Accounting Standard (AS) 17. Hence the opinion of chief accountant is wrong.

## Question 2

*A Company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 25% above cost. Is the policy adopted by the company correct?*

(*Source: Illustration 2, Study Material*)

**Answer**

AS 17 'Segment Reporting' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence the enterprise can have its own policy for pricing inter-segment transfers and hence inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

## Question 3

*M/s XYZ Ltd. has three segments namely X, Y, Z. The total Assets of the Company are ₹10.00 crores. Segment X has ₹2.00 crores, segment Y has ₹3.00 crores and segment Z has ₹5.00 crores. Deferred tax assets included in the assets of each segments are X–₹0.50 crores, Y– ₹0.40 crores and Z– ₹0.30 crores. The accountant contends that all the three segments are reportable segments. Comment.*

(*Source: Illustration 3, Study Material*)

**Answer**

According to AS 17 "Segment Reporting", segment assets do not include income tax assets. Therefore, the revised total assets are ₹8.8 crores [₹10 crores – (₹0.5 + ₹0.4 +₹0.3)]. Segment X holds total assets of ₹1.5 crores (₹2 crores –₹0.5 crores); Segment Y holds ₹2.6 crores (₹3 crores – ₹0.4 crores); and Segment Z holds ₹4.7 crores (₹5 crores – ₹0.3 crores). Thus all the three segments hold more than 10% of the total assets, all segments are reportable segments.

## Question 4

*Prepare a segmental report for publication in Diversifiers Ltd. from the following details of the company's three divisions and the head office:*

| | *₹('000)* |
|---|---|
| *Forging Shop Division* | |
| Sales to Bright Bar Division | *4,575* |
| *Other Domestic Sales* | *90* |
| *Export Sales* | *6,135* |
| *Bright Bar Division* | *10,800* |
| *Sales to Fitting Division* | *45* |
| *Export Sales to Rwanda* | *300* |
| *Fitting Division* | *345* |
| *Export Sales to Maldives* | *270* |

| **Particulars** | **Head Office ₹('000)** | **Forging Shop Division ₹('000)** | **Bright Bar Division ₹('000)** | **Fitting Division ₹('000)** |
|---|---|---|---|---|
| *Pre-tax operating result* | | *240* | *30* | *(12)* |
| *Head office cost reallocated* | | *72* | *36* | *36* |
| *Interest costs* | | *6* | *8* | *2* |
| *Fixed assets* | *75* | *300* | *60* | *180* |
| *Net current assets* | *72* | *180* | *60* | *135* |
| *Long-term liabilities* | *57* | *30* | *15* | *180* |

(*Source: Illustration 4, Study Material*)

**Answer**

**Diversifiers Ltd. Segmental Report**

***(₹'000)***

| Particulars | Divisions | | | Inter Segment Eliminations | Consolidated Total |
|---|---|---|---|---|---|
| | Forging shop | Bright Bar | Fitting | | |
| Segment Revenue | | | | | |
| Sales: | | | | | |
| Domestic | 90 | | | | 90 |
| Export | 6,135 | 300 | 270 | — | 6,705 |
| External Sales | 6,225 | 300 | 270 | | 6,795 |
| Inter-Segment Sales | 4,575 | 45 | - | 4,620 | — |
| Total Revenue | 10,800 | 345 | 270 | 4,620 | 6,795 |
| Segment Result (Given) | 240 | 30 | (12) | | 258 |
| Head Office Expenses | | | | | (144) |
| Operating Profit | | | | | 114 |
| Interest Expense | | | | | (16) |
| Profit Before Tax | | | | | 98 |
| Information in Relation to Assets and Liabilities: | | | | | |
| Fixed Assets | 300 | 60 | 180 | | 540 |
| Net Current Assets | 180 | 60 | 135 | — | 375 |
| Segment assets | 480 | 120 | 315 | — | 915 |
| Unallocated Corporate Assets (75 + 72) | | | | | 147 |
| Total assets | | | | | 1,062 |
| Segment liabilities | 30 | 15 | 180 | | 225 |
| Unallocated corporate liabilities | | | | | 57 |
| Total liabilities | | | | | 282 |

**Sales Revenue by Geographical Market**

**(₹'000)**

| | Home Sales | Export Sales (by forging shop division) | Export to Rwanda | Export to Maldives | Consolidated Total |
|---|---|---|---|---|---|
| External sales | 90 | 6,135 | 300 | 270 | 6,795 |

## Question 5

*Microtech Ltd. produces batteries for scooters, cars, trucks, and specialised batteries for invertors and UPS. How many segments should it have and why?*

(*Source: Illustration 5, Study Material*)

**Answer**

In case of Microtech Ltd., the basic product is the batteries, but the risks and returns of the batteries for automobiles (scooters, cars and trucks) and batteries for invertors and UPS are affected by different set of factors. In case of automobile batteries, the risks and returns are affected by the Government policy, road conditions, quality of automobiles, etc. whereas in case of batteries for invertors and UPS, the risks and returns are affected by power condition, standard of living, etc. Therefore, it can be said that Microtech Ltd. has two business segments viz- 'Automobile batteries' and 'batteries for Invertors and UPS'.

***Reference:*** The students are advised to refer the full text of AS 17 "Segment Reporting".

## Question 6

*Nathan Limited has three segments namely P, Q and R. The assets of the company are ₹15 crores. Segment P has 4 crores, Segment Q has 6 crores and Segment R has 5 crores. Deferred tax assets included in the assets of each segment are P - ₹1 crore, Q - ₹0.90 crores and R - ₹0.80 crores. The accountant contends all these three segments are reportable segments. Comment.*

(*Source: Question 6, Study Material*)

**Answer**

According to AS 17 "Segment Reporting", segment assets do not include income tax assets.

Therefore, the revised total assets are 12.3 crores [₹15 - (₹1 +0.9 + 0.8).

*Details of Segment wise assets:*

Segment P holds total assets of ₹3 crores (₹4 crores - ₹1 crores); Segment Q holds ₹5.1 crores (₹6 crores - ₹0.9 crores);

Segment R holds ₹4.2 crores (₹5 crores - ₹0.8 crores).

Thus, all the three segments hold more than 10% of the total assets, all segments are reportable segments.

Hence, the contention of the Accountant that all three segments are reportable segments is correct.

## Question 7

*Company A is engaged in the manufacture and sale of products, which constitute two distinct business segments. The products of the Company are sold in the domestic market only. The management information system of the Company is organized to reflect operating information by two broad market segments, rural and urban.*

*Besides the two business segments, how should Company A identify geographical segments? Do geographical segments exist within the same country? Explain in line with the provisions of AS 17.*

(*Source: Question 7, Study Material*)

**Answer**

AS 17 explains that, "a single geographical segment does not include operations in economic environments with significantly differing risks and returns. A geographical segment may be a single country, a group of two or more countries, or a region within a country".

Accordingly, to identity geographical segments, Company A needs to evaluate whether the segments reflected in the management information system function in environments that are subject to significantly differing risks and returns irrespective of the fact whether they are within the same country.

The Standard recognizes that, "Determining the composition of a business or geographical segment involves a certain amount of judgement…". Accordingly, while the management information system of the Company provides segment information for rural and urban geographical segments for the purpose of internal reporting, judgement is required to determine whether these segments are subject to significantly differing risks and returns based on the definition of geographical segment. In making such a judgement, aspect like different pricing and other policies, e.g., credit policies, deployment of resources between different regions etc., may be considered for the purpose identifying 'urban and 'rural' as separate geographical segment.

Company A, in making judgment for identifying geographical segments, should also consider the relevance, reliability and comparability over time of segment information that will be reported. The Standard, explains that, "In making that judgement, enterprise management takes into account the objective of reporting financial information by segment as set forth in the standard and the qualitative characteristics of financial statements. The qualitative characteristics include the relevance, reliability and comparability over time of financial information that is reported about the different groups of products and services of an enterprise and about its operations in particular geographical areas, and the usefulness of that information for assessing the risks and returns of the enterprise."

## Question 8

*PK Ltd. has identified business segment as its primary reporting format. It has identified India, USA and UK as three geographical segments. It sells its products in the Indian market, which constitutes 70 percent of the Company's sales. 25 per cent is sold in USA and the balance is sold in UK.*

*Is PK Ltd. as part of its geographical secondary segment information, required to disclose segment revenue from export sales, where such sales are not significant?*

(*Source: Question 8, Study Material*)

**Answer**

As per AS 17, if primary format of an enterprise for reporting segment information is business segments, it should also report segment revenue from external customers by geographical area based on the geographical location of its customers, for each geographical segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue.

Therefore, for the purposes of disclosing secondary segment information, PK Ltd. is not required to disclose segment revenue from export sales to UK, since that segment does not meet the 10 per cent or more of enterprise revenue threshold. However, other secondary segment information as per AS 17 should be disclosed in respect of this segment if the thresholds prescribed in the AS 17 are met.

## Question 9

*XYZ Ltd. has 5 business segments. Profit / Loss of each of the segments for the year ended 31st March, 20X2 have been provided below. You are required to identify from the following whether reportable segments or not reportable segments, on the basis of "profitability test" as per AS-17.*

| ***Segment*** | ***Profit (Loss) ₹in lakhs*** |
|---|---|
| *A* | *225* |
| *B* | *25* |
| *C* | *(175)* |
| *D* | *(20)* |
| *E* | *(105)* |

(*Source: Question 9, Study Material*)

**Answer**

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

Its segment results whether profit or loss is 10% or more of:

- The combined result of all segments in profit; i.e. ₹250 Lakhs or
- The combined result of all segments in loss; i.e. ₹300 Lakhs whichever is greater in absolute amount i.e. ₹300 Lakhs.

| **Operating Segment** | **Absolute amount of Profit or Loss (₹In lakhs)** | **Reportable Segment Yes or No** |
|---|---|---|
| A | 225 | Yes |
| B | 25 | No |
| C | 175 | Yes |
| D | 20 | No |
| E | 105 | Yes |

On the basis of the profitability test (result criteria), segments A, C and E are reportable segments (since their results in absolute amount is 10% or more of₹300 lakhs i.e. 30 lakhs).

## Question 10

*ABC Limited has 5 segments namely A, B, C, D and E. The profit/loss of each segment for the year ended March 31st, 20X2 is as follows:*

| ***Segment*** | ***Profit/(Loss)*** ***(₹in crore)*** |
|---|---|
| *A* | *780* |
| *B* | *1,500* |
| *C* | *(2,300)* |
| *D* | *(4,500)* |
| *E* | *6,000* |
| *Total* | *1,480* |

*Identify the Reportable segments.*

(*Source: Question 10, Study Material*)

**Answer**

In compliance with AS 17, the segment profit/loss of respective segment will be compared with the greater of the following:

(i) All segments in profit, i.e., A, B and E - Total profit ₹8,280 crores.

(ii) All segments in loss, i.e., C and D - Total loss ₹6,800 crores.

Greater of the above - ₹8,280 crores.

Based on the above, reportable segments will be determined as follows:

| **Segment** | **Profit/(Loss)** | **Absolute Profit/Loss as a % of 8,280** | **Reportable Segment** |
|---|---|---|---|
| A | 780 | 9% | No |
| B | 1,500 | 18% | Yes |
| C | (2,300) | 28% | Yes |
| D | (4,500) | 54% | Yes |
| E | 6,000 | 72% | Yes |
| **Total** | **1,480** | | |

## Question 11

*Heavy Goods Ltd. has 6 segments namely L-Q (below).*

*The total revenues (internal and external), profits or losses and assets are set out below:*

***(In ₹)***

| ***Segment*** | ***Inter Segment Sales*** | ***External Sales*** | ***Profit / loss*** | ***Total assets*** |
|---|---|---|---|---|
| *L* | *4,200* | *12,300* | *3,000* | *37,500* |
| *M* | *3,500* | *7,750* | *1,500* | *23,250* |
| *N* | *1,000* | *3,500* | *(1,500)* | *15,750* |
| *0* | *0* | *5,250* | *(750)* | *10,500* |
| *P* | *500* | *5,500* | *900* | *10,500* |
| *Q* | *1,200* | *1,050* | *600* | *5,250* |
| | *10,400* | *35,350* | *3,750* | *1,02,750* |

*Heavy Goods Ltd. needs to determine how many reportable segments it has.*

*You are required to advice Heavy Goods Ltd. as per the criteria defined in AS 17.*

(*Source: Question 11, Study Material*)

**Answer**

Quantitative Threshold Test:

**Revenue Test:**

Combined total sales of all the segment = ₹10,400 + ₹35,350 = ₹45,750.

10% thresholds = 45,750 x 10% = 4,575.

**Profitability Test:**

In the given situation, combined reported profit = ₹6,000 and combined reported loss (₹2,250). Hence, for 10% thresholds ₹6,000 will be considered.

10% thresholds = ₹6,000 x 10% = ₹600

**Asset Test:**

Combined total assets of all the segment = ₹1,02,750 10% thresholds = ₹1,02,750 x 10% = 10,275

***Accordingly, quantitative thresholds are calculated below:***

| Segments | L | M | N | O | P | Q | Reportable segments |
|---|---|---|---|---|---|---|---|
| % segment sales to total sales | 36.66% | 24.59% | 9.84% | 11.48% | 13.11% | 4.92% | L, M,O,P |
| % segment profit to total profits | 50% | 25% | 25% | 12.5% | 15% | 10% | L,M,N,O,P,Q |
| % segment assets to total assets | 36.50% | 22.63% | 15.33% | 10.22% | 10.22% | 5.11% | L,M,N,O,P |

**Conclusion:**

Segments L, M, O and P clearly satisfy the revenue and assets tests and they are separate reportable segments.

Segment N does not satisfy the revenue test, but it does satisfy the asset test and it is a reportable segment.

Segment Q does not satisfy the revenue or the assets test but is does satisfy the profits test. Therefore, Segment Q is also a reportable segment.

Hence all segments i.e. L, M, N, O, P and Q are reportable segments.

## Question 12

*Calculate the segment results of a manufacturing organization from the following information:*

| ***Segments*** | ***A*** | ***B*** | ***C*** | ***Total*** |
|---|---|---|---|---|
| *Directly attributed revenue* | *5,00,000* | *3,00,000* | *1,00,000* | *9,00,000* |
| *Enterprise revenue* | | | | *1,10,000* |
| *(allocated in 5 :4 : 2 basis)* | | | | |
| *Revenue from transactions with* | | | | |
| *other segments* | | | | |
| *Transaction from B* | *1,00,000* | | *50,000* | *1,50,000* |
| *Transaction from C* | *10,000* | *50,000* | | *60,000* |
| *Transaction from A* | | *25,000* | *1,00,000* | *1,25,000* |
| *Operating expenses* | *3,00,000* | *1,50,000* | *75,000* | *5,25,000* |
| *Enterprise expenses* | | | | *77,000* |
| *(allocated in 5 :4 :2 basis)* | | | | |

| ***Segments*** | ***A*** | ***B*** | ***C*** | ***Total*** |
|---|---|---|---|---|
| *Expenses on transactions with other segments* | | | | |
| *Transaction from B* | *75,000* | | *30,000* | |
| *Transaction from C* | *6,000* | *40,000* | | |
| *Transaction from A* | | *18,000* | *82,000* | |

(*Source: Question 12, Study Material*)

**Computation of segment result:**

| **Segments** | **A** ₹ | **B** ₹ | **C** ₹ | **Total** ₹ |
|---|---|---|---|---|
| Directly attributed revenue | 5,00,000 | 3,00,000 | 1,00,000 | 9,00,000 |
| Enterprise revenue (allocated in 5 :4 :2 basis) | 50,000 | 40,000 | 20,000 | 1,10,000 |
| **Revenue from transactions with other segments** | | | | |
| Transaction from B | 1,00,000 | | 50,000 | 1,50,000 |
| Transaction from C | 10,000 | 50,000 | | 60,000 |
| Transaction from A | | 25,000 | 1,00,000 | 1,25,000 |
| **Total segment revenue (1)** | **6,60,000** | **4,15,000** | **2.70,000** | **13,45,000** |
| Operating expenses | 3,00,000 | 1,50,000 | 75,000 | 5,25,000 |
| Enterprise expenses (allocated in 5 :4 :2 basis) | 35,000 | 28,000 | 14,000 | 77,000 |
| Expenses on transactions with other segments | | | | |
| Transaction from B | 75,000 | | 30,000 | 1,05,000 |
| Transaction from C | 6,000 | 40,000 | | 46,000 |
| Transaction from A | | 18,000 | 82,000 | 1,00,000 |
| **Total segment expenses (2)** | **4,16,000** | **2,36,000** | **2,01,000** | **8,53,000** |
| **Segment result (1-2)** | **2,44,000** | **1,79,000** | **69,000** | **4,92,000** |

# QUESTION BANK

## Question 13

(a) Company A is engaged in the manufacture of chemicals. The company manufactures five types of chemicals that have different applications. Can this company include more than one type of chemical in a single business segment? Comment.

(b) Is an enterprise required to disclose changes in the basis of allocation of revenue and expenses to segments? Explain.

(*RTP November 2021*)

**Answer**

**(a)** As per AS 17, "A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products of services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:

(a) the nature of the products of services;

(b) the nature of the productions processes;

(c) the type of class of customers for the products or services;

(d) the methods use to distribute the products or provide the services; and

(e) if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities."

As per provisions of the standard, a single business segment does not include products and services with significantly differing risks and returns. Products and services included in a single business segment may be dissimilar with respect to one or several factors listed above but are expected to be similar with respect to majority of the factors.

In the present case, the Company should consider whether the chemicals with different applications, have similar risks end returns. For this purpose, the Company should ascertain whether one or more types of chemicals are related keeping in view the relevant factors including those given in the definition of business segment. Chemicals having different applications can be included in a single business segment if majority of the relevant factors including those listed above are similar. This would ensure that the chemicals having significantly different risks and returns are not included in a single business segment.

**(b)** As per AS 17, "Changes in accounting policies adopted for segment reporting that have a material effect on segment information should be disclosed. Such disclosure should include a description of the nature of the change, and the financial effect of the change if it is reasonably determinable." It also states that "some changes in accounting policies relate specifically to segment reporting. Examples include changes in identification of segments and changes in the basis for allocating revenues and expenses to segments. Such changes can have a significant impact on the segment information reported but will not change aggregate financial information reported for the enterprise. To enable users to understand and impact of such changes, this Statement requires the disclosure of the nature of change and the financial effect of the change, if reasonably determinable".

In view of the above, a change in the basis of allocation of revenue and expenses to segments is a change in the accounting policy adopted for segment reporting. Accordingly, if the change has a material financial effect on the segment information, a description of the nature of the change, and the financial effect of the change, if it is reasonably determinable, should be disclosed.

## Question 14

A Company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 25% above cost. Is the policy adopted by the company correct?

(*RTP November, 2022*)

**Answer**

AS 17 'Segment Reporting' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

## Question 15

The Senior Accountant of AMF Ltd. gives the following data regarding its five segments:

(*₹ in lakhs)*

| Particulars | P | Q | R | S | T | Total |
|---|---|---|---|---|---|---|
| | (₹) | (₹) | (₹) | (₹) | (₹) | (₹) |
| Segment Assets | 80 | 30 | 20 | 20 | 10 | 160 |
| Segment Results | (190) | 10 | 10 | (10) | 30 | (150) |
| Segment Revenue | 620 | 80 | 60 | 80 | 60 | 900 |

The Senior Accountant is of the opinion that segment "P" alone should be reported. Is he justified in his view? Examine his opinion in the light of provision of AS-17 'Segment Reporting'.

(*RTP May, 2023*)

**Answer**

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

(i) Its revenue from sales to external customers and from other transactions with o ther segments is 10% or more of the total revenue- external and internal of all segments; or

(ii) Its segment result whether profit or loss is 10% or more of:

   (1) The combined result of all segments in profit; or

   (2) The combined result of all segments in loss, whichever is greater in absolute amount; or

(iii) Its segment assets are 10% or more of the total assets of all segments.

   Accordingly,

   (a) On the basis of revenue from sales criteria, segment P is a reportable segment.

   (b) On the basis of the result criteria, segments P & T are reportable segments (since their results in absolute amount is 10% or more of ₹ 200 Lakhs).

   (c) On the basis of asset criteria, all segments except T are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reported upon in accordance with AS 17. Hence, the opinion of chief accountant that only segment 'P' is reportable is wrong.

## Question 16

The Accountant of X. Ltd. provides the following data regarding its five segments:

| Particulars | A | B | C | D | E | Total (₹in Crore) |
|---|---|---|---|---|---|---|
| Segment Assets | 50 | 20 | 15 | 10 | 5 | 100 |
| Segment Results | (85) | 10 | 10 | (15) | 5 | (75) |
| Segment Revenue | 250 | 50 | 40 | 60 | 30 | 430 |

The accountant is of the opinion that segment 'A' alone should be reported,

Is he justified in his view ? Examine his opmion in the light' of provisions of AS-17 Segment Reporting.

(*G-II, May, 2023*) (*5 Marks*)

CHAPTER 7

# Accounting Standard 18 Related Party Disclosures

## Question 1

*Identify the related parties in the following case as per AS 18: A Ltd. holds 51% of B Ltd. B Ltd holds 51% of O Ltd. Z Ltd holds 49% of O Ltd.*

(*Source: Illustration 1, Study Material*)

**Answer**

In relation to Reporting enterprise - A Ltd.

- B Ltd. (subsidiary) is a related party
- O Ltd.(subsidiary) is a related party In relation to Reporting enterprise - B Ltd.
- A Ltd. (holding company) is a related party
- O Ltd. (subsidiary) is a related party In relation to Reporting enterprise - O Ltd.
- A Ltd. (ultimate holding company) is a related party
- B Ltd. (holding company) is a related party
- Z Ltd. (investor/ investing party) is a related party (O Ltd being Associate of Z Ltd)

Reporting enterprise - Z Ltd.

- O Ltd. (Associate) is a related party

## Question 2

*Consider a scenario wherein:*

- *A Ltd. has 60% voting right in B Ltd.*
- *A Ltd. also has 22% voting right in C Ltd.; and*
- *B Ltd. has 30% voting right in C Ltd.*

*Whether C Ltd. is to be treated under AS-18 as a party related to A Ltd.?*

(*Source: Illustration 2, Study Material*)

**Answer**

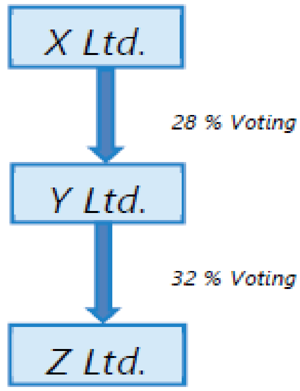
Yes – in relation to A Ltd. (the reporting enterprise), C Ltd. is a related party under AS-18. This is because A Ltd. *indirectly controls* C Ltd.

In this case, A Ltd. (together with its subsidiary B Ltd.) controls *more than one half of the voting right*s of C Ltd.

## Question 3

*Consider a scenario wherein:*

- *X Ltd. holds 28% voting right in Y Ltd. (and hence Y Ltd. is an associate of X Ltd.)*
- *Y Ltd. holds 32% voting right in Z Ltd. (and hence Z Ltd. is an associate of Y Ltd.)*




*In the above case, since Y Ltd. is an associate of X Ltd. – Y Ltd. is a related party to X Ltd.*

*Likewise, since Z Ltd. is an associate of Y Ltd. - Z Ltd. is a related party to Y Ltd.*

*The question is: Whether Z Ltd. is to be treated under AS-18 as a party related to X Ltd.?*

(*Source: Illustration 3, Study Material*)

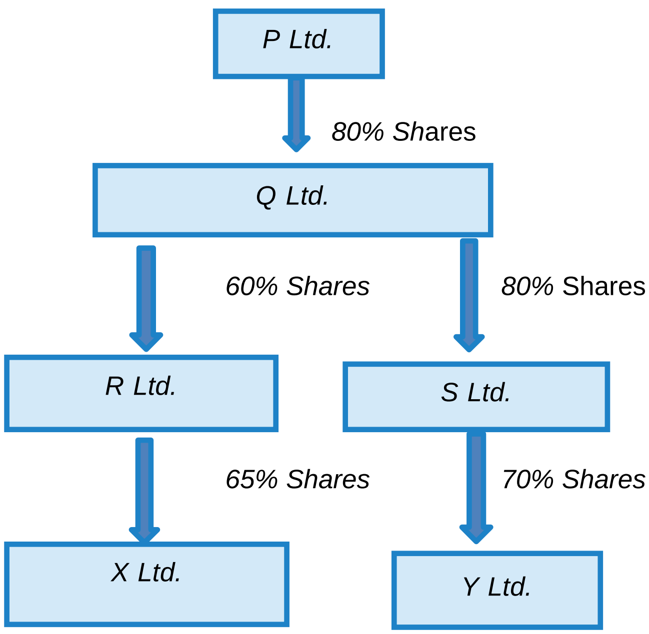
**Answer**

No – in relation to X Ltd. (the reporting enterprise), Z Ltd. is a **not** a related party. This is because as per the requirements of AS-18, '*associate of an associate'* is **not**

a related party.

## Question 4

*Consider the following organization structure related to P Ltd.*




*Given the above structure: Identify related party relationships, if R Ltd. is the reporting enterprise*

(*Source: Illustration 4, Study Material*)

**Answer**

The following table identifies the related party relationships for R Ltd. (being the reporting enterprise):

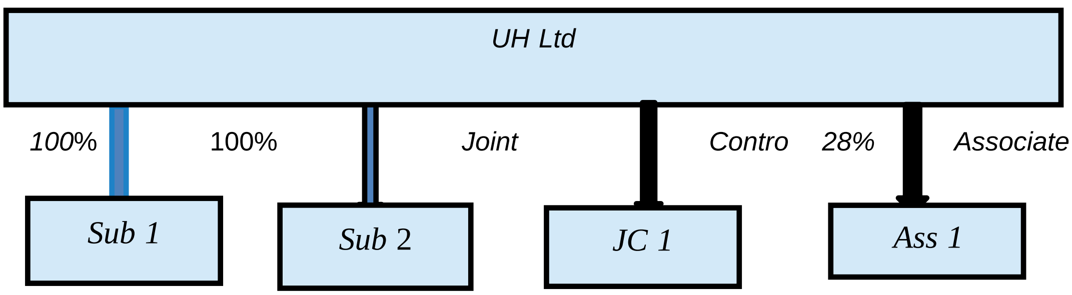
| Party Name | Relationship under AS-18 |
|---|---|
| **P Ltd.** | • P Ltd. has *indirect control* on R Ltd. (through Q Ltd.)<br>• Hence R Ltd. is related to P Ltd. |

| | |
|---|---|
| **Q Ltd.** | • Q Ltd. has direct control of R Ltd.<br>• Hence R Ltd. is related to Q Ltd. |
| **S Ltd.** | • R Ltd. and S Ltd. are under common control of Q Ltd.<br>• Hence R Ltd. is related to S Ltd. |
| **X Ltd.** | • X Ltd. is controlled by R Ltd.<br>• Hence R Ltd. is related to X Ltd. |
| **Y Ltd.** | • Y Ltd. is the sub-subsidiary of Q Ltd.<br>• Both R Ltd. and Y Ltd. are under common control of Q Ltd.<br>• Hence R Ltd. is related to Y Ltd. |

## Question 5

*Consider the following organization structure related to UH Ltd. (the ultimate parent company of a Group), wherein UH Ltd. has made the following investments:*

- *Investment in two of the wholly owned subsidiaries, viz. Sub 1 and Sub 2*
- *Investment in JC 1, in which UH Ltd. has a joint control*
- *20% investment in Ass 1 (and hence, Ass 1 is an associate of UH Ltd.)*




*Given the above structure: Identify related party relationships for each of the above entities under AS-18*

(*Source: Illustration 5, Study Material*)

**Answer**

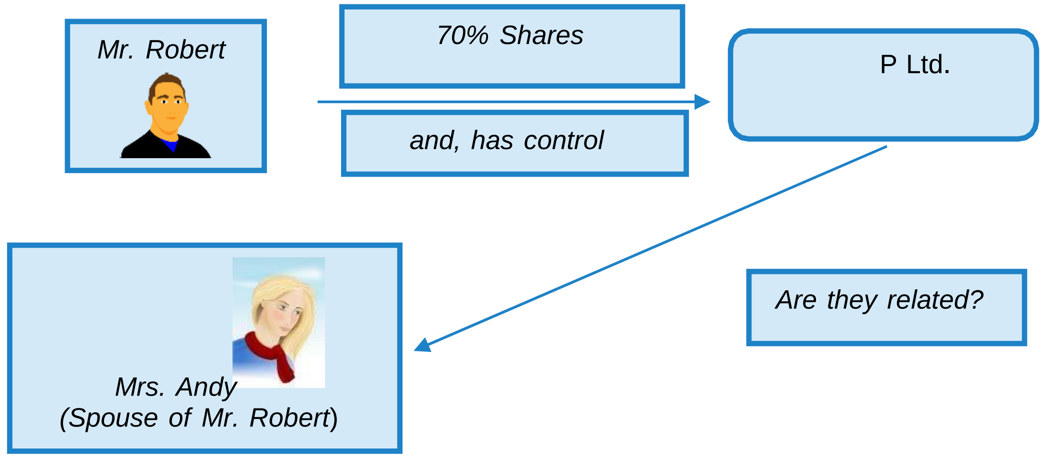
The following table identifies the related party relationships for each of the entities in the Group:

| Reporting enterprise | Related Party as per AS-18 |
|---|---|
| **UH Ltd.** | All the four entities (viz. Sub 1, Sub 2, JC 1 and Ass 1) |
| **Sub 1** | Only two of the entities in the Group (viz. UH Ltd. and Sub 2) |
| **Sub 2** | Only two of the entities in the Group (viz. UH Ltd. and Sub 1) |
| **JC 1** | Only UH Ltd. |
| **Ass 1** | Only UH Ltd. |

## Question 6

*Consider a scenario wherein:*

- *Mr. Robert holds 70% shares and voting rights in P Ltd*




*Determine: Whether Andy (spouse of Mr. Robert) is a related party to P Ltd. under AS-18?*

(*Source: Illustration 6, Study Material*)

**Answer**

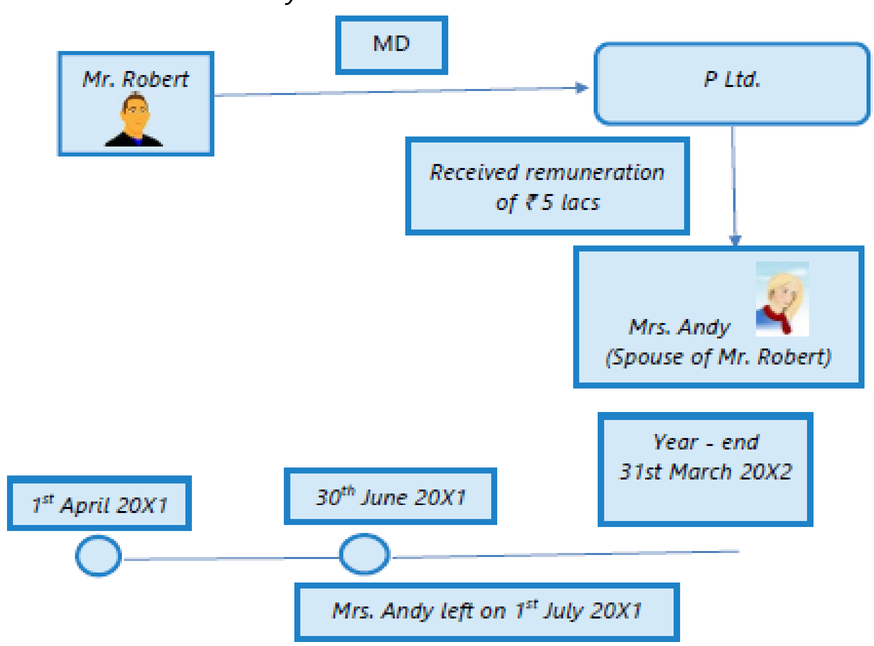
Yes – Andy is a related party to P Ltd., in view of the requirements of AS-18.

It may be recalled that under AS-18 'relatives of individuals owning an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise' are considered as related parties.

## Question 7

*Consider a scenario wherein:*

- *Mr. Robert is a Managing Director of P Ltd.*
- *Andy (spouse of Robert) received a remuneration of ₹ 5 lacs from P Ltd. – for the services she rendered to P Ltd. for the period 1st April 20X1 through 30th June 20X1*
- *Andy left the services of P Ltd. on 1st July 20X1*
- *Consider 31st March 20X2 as the year-end date for P Ltd.*



*Whether Andy is to be identified as related party at the year-end date (31st March 20X2) for the purposes of AS-18?*

(*Source: Illustration 7, Study Material*)

**Answer**

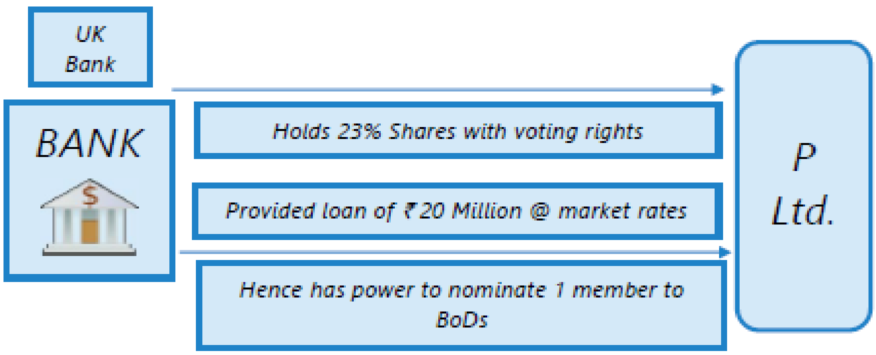
Yes – This is because as per AS-18, parties are considered to be related if *at any time during the reporting period* one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Hence Andy (being the spouse *and* relative of the KMP of P Ltd.) **needs to be reported** as related party at the year-end date (i.e. 31st March 20X2). This is because the remuneration Andy received from P Ltd. (for the period April 20X1 to 30 June 20X1) *falls within the reporting year April 20X1 to March 20X2*.

## Question 8

*Consider a scenario wherein:*

- *UK Bank holds 23% equity shares with voting rights in P Ltd.*
- *The bank has provided a loan of ₹ 20 million to P Ltd. at market interest rate*
- *As per the terms and conditions of the loan agreement, the bank has appointed one person as its nominee to the board of directors of P Ltd. and any major transaction to be entered into by P Ltd. will require the consent of the Bank*




*Determine: Whether under AS-18 - UK Bank is a related party to P Ltd. (the reporting enterprise)?*

(*Source: Illustration 8, Study Material*)

**Answer**

In the instant case, the UK Bank holds 23% shares with voting rights in P Ltd. and hence is deemed to exercise significant influence over P Ltd.

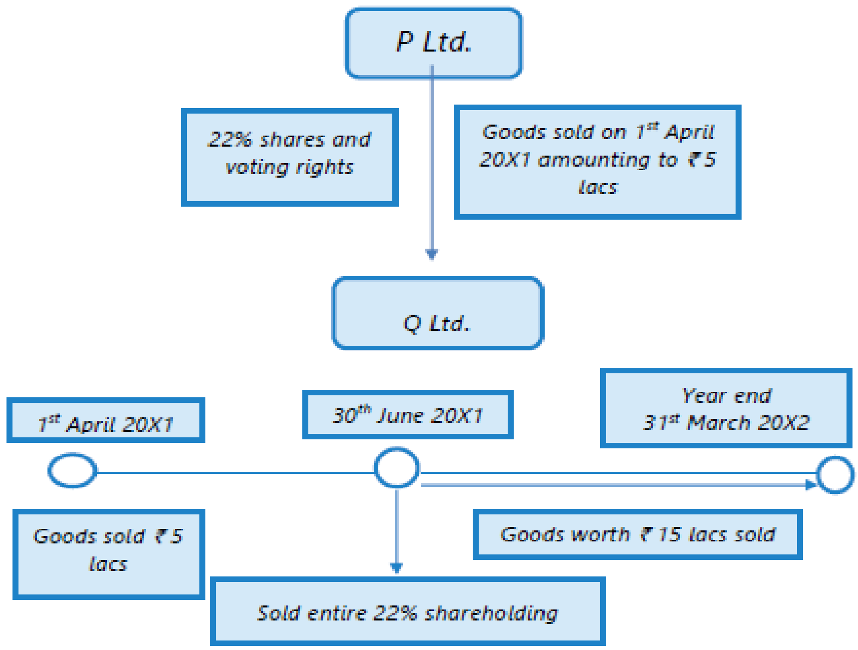
The bank is also a provider of finance to P Ltd. (the reporting enterprise) and as per AS-18, parties like providers of finance are deemed ***not to be considered*** as a related party in the course of *normal dealings with an enterprise* by virtue ***only of those dealings*****.** However, this exemption will not be available to UK Bank in this case – since it exercises significant influence over P Ltd. (by virtue of holding 23% shares with voting rights in P Ltd.)

Accordingly, for P Ltd. (the reporting enterprise), the UK Bank is a related party and it will be required to disclose the transactions with UK Bank in its financial statements.

## Question 9

*Consider a scenario wherein:*

- *P Ltd. hold 22% shares and voting rights in Q Ltd. (and hence Q Ltd. is an associate of P Ltd.)*
- *On 1st April 20X1, P Ltd. sold certain goods to Q Ltd. amounting to ₹ 5 lacs*
- *On 30th June 20X1, P Ltd. sold its entire 22% stake in Q Ltd. (and hence the related party relationship ceased to exist after 30th June 20X1)*
- *However, P Ltd. continued supply goods to Q Ltd. subsequent to 30th June 20X1 (just like any other customer) and sold goods worth ₹ 15 lacs during 9-month period ended 31st March 20X2*
- *Consider 31st March 20X2 as the year-end date for P Ltd.*




*Determine whether the transaction for the entire year (ending on 31st March 20X2) is required to be disclosed under AS-18 as related party transaction.*

(*Source: Illustration 9, Study Material*)

**Answer**

No – This is because as per AS-18, the disclosure requirements under the Standard relate *only to the period* ***during related party relationship existed.***

Accordingly, only *transactions between P Ltd and Q Ltd till 30th June 20X1* (being sale of goods worth ₹ 5 lacs) are required to be reported / disclosed under AS- 18.

Transactions entered into after 30th June 20X1 are **NOT required** to be disclosed under AS-18.

## Question 10

*Narmada Ltd. sold goods for ₹90 lakhs to Ganga Ltd. during financial year ended 31-3-20X1. The Managing Director of Narmada Ltd. owns 100% shares of Ganga Ltd. The sales were made to Ganga Ltd. at normal selling prices by Narmada Ltd. The Chief accountant of Narmada Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. Is the Chief Accountant correct?*

(*Source: Illustration 10, Study Material*)

**Answer**

As per AS 18 'Related Party Disclosures', Enterprises over which a key management personnel is able to exercise significant influence are related parties. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprise that have a member of key management in common with the reporting enterprise.

In the given case, Narmada Ltd. and Ganga Ltd are related parties and hence disclosure of transaction between them **is required** *irrespective of* whether the transaction was done at *normal selling price*.

Hence the contention of Chief Accountant of Narmada Ltd is **wrong.**

## Question 11

*Who are related parties under AS 18? What are the related party disclosure requirements?*

(*Source: Question 6, Study Material*)

**Answer**

Parties are considered to be related if at *any time during the reporting period* one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

(i) The name of the transacting related party;

(ii) A description of the relationship between the parties;

(iii) A description of the nature of transactions;

(iv) Volume of the transactions either as an amount or as an appropriate proportion;

(v) Any other elements of the related party transactions necessary for an understanding of the financial statements;

(vi) The amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date;

(vii) Amounts written off or written back in the period in respect of debts due from or to related parties.

## Question 12

*ABC Limited is in the business of manufacturing textiles. It has certain commercial contracts with its customers and those customer contracts carry various clauses, imposing restriction on ABC Limited for disclosure of certain information. Accordingly, the company doesn't intend to provide related party disclosure under AS-18 in its ensuing financial statements. Is this correct?*

(*Source: Question 7, Study Material*)

**Answer**

As per AS-18 stipulate that related party disclosure requirements under AS- 18 ***do not apply*** in circumstances, where providing such disclosures would conflict with the reporting enterprise's duties of confidentiality, as specifically required in terms of a statute or by any regulator or similar competent authority.

In case, where (1) a statute or (2) a regulator or (3) a similar competent authority governing an enterprise prohibit the enterprise to disclose certain information, which is required to be disclosed as per AS 18, disclosure of such information is ***not warranted.*** For example, banks are obliged by law to maintain confidentiality in respect of their customers' transactions and AS-18 would not override the obligation to preserve the confidentiality of customers' dealings.

However, this exemption is ***not available*** in respect of *confidentiality provisions in a commercial contract between two enterprises* - where confidentiality is not specifically required in terms of (1) a statute or (2) by any regulator or (3) similar competent authority.

Therefore, in the given case AS-18 related party disclosures would have to be made by ABC Limited in its ensuing financial statements.

## Question 13

*Should the related parties be identified as at the reporting date (i.e. balance sheet date) for the purposes of AS-18? In disclosing transactions with related parties, are the transactions of the entire reporting period to be disclosed or only those for the period during which related party relationship exists?*

(*Source: Question 8, Study Material*)

**Answer**

As per the definition of related parties in AS-18, the *existence* of a related party relationship should be identified at all points during the year (*and* not only at the close of the financial year). However, AS 18 requires disclosure of transactions with these parties *only during the existence of* the related party relationship.

## Question 14

*Mr. Raj, a relative of key management personnel, received remuneration of ₹2,50,000 for his services in the company for the period from 1.4.20X1 to 30.6.20X1. On 1.7.20X1, he left the service of the company.*

*Should the relative be identified as at the closing date i.e. on 31.3.20X2 for the purposes of AS 18?*

(*Source: Question 9, Study Material*)

**Answer**

According to AS 18 on 'Related Party Disclosures', parties are considered to be related if *at any time during the reporting period* one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Hence Mr. Raj, a relative of key management personnel, should be identified as related party for disclosure in the financial statements for the year ended 31.3.20X2.

## Question 15

*X Ltd. sold goods to its associate company during the 1st quarter ended 30.6.20X1. After that, the related party relationship ceased to exist. However, goods were supplied as were supplied to any other ordinary customer. Decide whether transactions of the entire year have to be disclosed as related party transaction.*

(*Source: Question 10, Study Material*)

**Answer**

As per AS 18, transactions of X Ltd. with its associate company for the first quarter ending 30.06.20X1 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did not exist would not be reported.

## Question 16

*You are required to identify the related parties in the following cases as per AS 18:*

*M Ltd. holds 61 % shares of S Ltd. S Ltd. holds 51 % shares of F Ltd. C Ltd. holds 49% shares of F Ltd.*

*(Give your answer - Reporting Entity wise for M Ltd., S Ltd., C Ltd. and F Ltd.)*

(*Source: Question 11, Study Material*)

**Answer**

| Reporting Entity | Related Party |
|---|---|
| M Ltd. | S Ltd. (subsidiary) F Ltd.(subsidiary) |
| S Ltd. | M Ltd. (holding company) F Ltd. (subsidiary) |
| F Ltd. | M Ltd. (ultimate holding company) S Ltd. (holding company)<br>C Ltd. (investor/ investing party) |
| C Ltd. | F Ltd. (associate) |

# QUESTION BANK

## Question 17

Is remuneration paid to Board of Directors a related party transaction? Explain.

(*RTP May 2018*)

**Answer:**

In case of a Company, the Managing Director, whole time director, manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered Key Managerial Personnel (KMP).

Persons who do not have the authority and responsibility for planning, directing and controlling the activities of the enterprise would not be KMP. Conversely, persons without any formal titles may be considered to be KMP, if they plan, direct and control the activities of the enterprise.

Hence, remuneration paid to Board of Directors will be considered as related party transaction.

## Question 18

Following transactions are disclosed as on 31st March, 2018:

(i) Mr. Sumit, a relative of Managing Director, received remuneration of ₹2,10,000 for his services in the company for the period from 1st April, 2017 to 30th June, 2017. He left the service on 1st July, 2017.

Should the relative be identified as a related party as on closing date i.e. on 31-3-2018 for the purpose of AS 18.

(ii) Goods sold amounting to ₹50 lakhs to associate company during the 1st quarter ended on 30th June, 2017. After that related party relationship ceased to exist. However, goods were supplied as was supplied to any other ordinary customer.

Decide whether transactions of the entire year have to be disclosed as related party transactions.

*(November 2018) (5 marks)*

**Answer**

(i) According to AS 18 'Related Party Disclosures', parties are considered to be related if at any time during the reporting period, one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Hence, Mr. Sumit a relative of key management personnel should be identified as related party as at the closing date i.e. on 31.3.2018 as he received remuneration for his services in the company from 1st April, 2017 to 30th June, 2017and this period comes under the reporting period.

(ii) As per provision of AS 18, the transactions only for the period in which related party relationships exist need to be reported.

Hence, transactions of the entity with its associate company for the first quarter ending 30.06.2017 only are required to be disclosed as related party transactions. Transactions of the entire year need not be disclosed as related party transactions and transactions for the period (after 1st July) in which related party relationship did not exist need not be reported.

Hence transaction of sale of goods with the associate company for first quarter ending 30th June, 2017 for ₹50 Lakhs only are required to be disclosed as related party transaction on 31.3.18.

## Question 19

Sun Ltd. sold goods for ₹50 lakhs to Moon Ltd. during financial year ended 31st March 2017 at normal selling price followed by Sun Ltd. The Managing Director of Sun Ltd. holds 75% shares of Moon Ltd. The Chief accountant of Sun Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. You are required to examine and advise whether the contention of the Chief Accountant is correct?

(*RTP November 2018*)

**Answer:**

As per AS 18 'Related Party Disclosures', Enterprises over which a key management personnel is able to exercise significant influence are related parties. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprise that have a member of key management in common with the reporting enterprise.

In the given case, Sun Ltd. and Moon Ltd are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price.

Hence the contention of Chief Accountant of Sun Ltd is wrong.

## Question 20

SP hotels Limited enters into an agreement with Mr. A for running its hotel for a fixed return payable to the later every year. The contract involves the day-to-day management of the hotel, while all financial and operating policy decisions are taken by the Board of Directors of the company. Mr. A does not own any voting power in SP Hotels Limited. Would he be considered as a related party of SP Hotels Limited"?

**Answer:**

Mr. A will not be considered as a related party of SP Hotels Limited in view of paragraph 3(c) of AS 18 which states, Individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual". In the above example, in the absence of share ownership, Mr. A would not be considered to exercise significant influence on SP Hotels Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr. A does not have the ability to director instruct the board of directors does not qualify him as a key management personnel.

## Question 21

Identify the related parties in the following cases as per AS-18

(i) May Ltd. holds 61% shares of Sheetal Ltd.
Sheetal Ltd. holds 51% shares of Fair Ltd.
Care Ltd. holds 49% shares of Fair Ltd.
(Give your answer Reporting Entity wise for Maya Ltd., Sheetal Ltd., Care Ltd. and Fair Ltd.)

(ii) Mr. Subhash Kumar is Managing Director of A Ltd. and also holds 72% capital of B Ltd. (B Ltd. is subsidiary of A Ltd.)

(*May 2019*) (*5 Marks*)

**Answer:**

**(i)** (a) Reporting entity- Maya Ltd.
- Sheetal Ltd. (subsidiary) is a related party
- Fair Ltd. (subsidiary) is a related party

(b) Reporting entity- Sheetal Ltd.
- Maya Ltd. (holding company) is a related party
- Fair Ltd. (subsidiary) is a related party

(c) Reporting entity- Fair Ltd.
- Maya Ltd. (holding company) is a related party
- Sheetal Ltd. (holding company) is a related party
- Care Ltd. (investor/investing party) is a related party

(d) Reporting entity- Care Ltd.
- Fair Ltd. (associate) is a related party

(ii) Mr. Subhash Kumar is Key management personnel as he has the authority for planning, directing and controlling the activities of A Ltd. He also holds substantial interest in B Ltd. as he holds 72% capital of B Ltd. Thus, Mr. Subhash is related party for both A Ltd. and B Ltd. Moreover, as per the definition of related party relationship described in para 3 of AS 18, enterprises over which Subhash is able to exercise significant influence are also related parties. Thus, a Ltd. and B Ltd. will also be construed as related to each other.

## Question 22

Arohi Ltd. sold goods for ₹90 lakhs to Anya Ltd. during financial year ended 31-3-2019. The Managing Director of Arohi Ltd. own 100% of Anya Ltd. The sales were made to Anya Ltd. at normal selling prices followed by Arohi Ltd. The Chief accountant of Arohi Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. Is the Chief Accountant correct? Comment in accordance with AS 18.

(*May 2020*)

**Answer**

As per AS 18 'Related Party Disclosures', Enterprises over which the key management personnel is able to exercise significant influence are related parties. This includes enterprises owned by directors or major shareholders of the reporting enterprise that have a member of key management in common with the reporting enterprise. In the given case, Arohi Ltd. and Anya Ltd. are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price. Hence the contention of Chief Accountant of Arohi Ltd. is wrong.

## Question 23

You are required to identify the related parties in the following cases as per AS 18: M Ltd. holds 61 % shares of S Ltd.

S Ltd. holds 51 % shares of F Ltd.

C Ltd. holds 49% shares of F Ltd.

(Give your answer - Reporting Entity wise for M Ltd., S Ltd., C Ltd. and F Ltd.)

(*MTP, May, 2020*) (*5 marks*)

**Answer:**

**(i)** (a) Reporting entity- M Ltd.
- S Ltd. (subsidiary) is a related party
- F Ltd.(subsidiary) is a related party

(b) Reporting entity- S Ltd.
- M Ltd. (holding company) is a related party
- F Ltd. (subsidiary) is a related party

(c) Reporting entity- F Ltd.
- M Ltd. (holding company) is a related party
- S Ltd. (holding company) is a related party
- C Ltd. (investor/ investing party) is a related party

(d) Reporting entity- C Ltd.
- F Ltd. (associate) is a related party

## Question 24

(i) Mr. Arnav a relative of key management personnel received remuneration of ₹3,00,000 for his services in the company for the period April 1, 2019 to June 30, 2019. On July 1, 2019 he left the job. Should Mr. Arnav be identified as Related Party at the closing date i.e. March 31, 2020 for the purposes of AS 18?

(ii) A limited company sold goods to its associate company for the 1st quarter ending June 30, 2020. After that, the related party relationship ceased to exist. However, goods were supplied continuously even after June 30, 2020 as was supplied to another ordinary customer. Does this require disclosure as related party transaction for the entire financial year?

(*MTP, October, 2020*) (*5 marks*)

**Answer**

**(i)** According to AS 18 'Related Party Disclosures', parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Hence**,** Mr. Arnav a relative of key management personnel should be identified as related party as at the closing date i.e. on 31.3.2020.

**(ii)** As per AS 18, transactions of company with its associate company for the first quarter ending 30.06.2020 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did not exist need not be reported.

## Question 25

On the basis of provisions of AS 18 'Related Party Disclosures':

(i) Identify the related parties in the following cases:
X Limited holds 60% shares of Y Limited
Y Limited holds 55% shares of W Limited
Z Limited holds 35% shares of W Limited

(ii) Himalaya Limited sold goods for ₹40 Lakhs to Aravalli Limited during financial year ended on March 31, 2019. The Managing Director of Himalaya Limited owns 80% shares of Aravalli Limited. The sales were made to Aravalli Limited at normal selling prices followed by Himalaya Limited. The chief accountant of Himalaya Limited contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per AS 18. You are required to comment on this.

(*RTP, November, 2020*)

**Answer**

(i) X Ltd., Y Ltd. & W Ltd. are related to each other. Z Ltd. & W Ltd. are related to each other by virtue of associate relationship. However, neither X Ltd. nor Y Ltd. is related to Z Ltd. and vice versa since neither control nor significant influence exists between them.

(ii) Himalaya Ltd. and Aravalli Ltd are related parties since key management personnel of Himalaya Ltd. ie. its managing director holds 80% in Aravalli Ltd. and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price. Hence the contention of Chief Accountant of Himalaya Ltd that these sales require no disclosure under related party Transactions, is wrong.

## Question 26

(i) Khushi Limited enter into an agreement with Mr. Happy for running a business for a fixed amount payable to the later every year. The contract states that the day-to-day management of the business will be handled by. Mr. Happy, while all financial and operating policy decisions are taken by the Board of Directors of the Company. Mr. Happy does not own any voting power in Khushi Limited.

(ii) Shri Bhanu a relative of key management personnel received remuneration of ₹3,50,000 for his services in the company for the period from 1st April, 2020 to 30th June, 2020. On 1st July, 2020, he left the service.

You are required to suggest how the above transactions will be treated as at the closing date i.e. on 31st March, 2021 for the purposes of AS 18- Related Party Disclosures.

(*July, 2021 Suggested*) (*5 Marks*)

**Answer**

(i) Mr. Happy will not be considered as a related party of Khushi Limited in view of provisions of AS 18 "Related Party Disclosures" which states, "individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual are related parties".

In the given case, in the absence of share ownership, Mr. Happy would not be considered to exercise significant influence on Khushi Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr Happy does not have the ability to direct or instruct the board of directors does not qualify him as a key management personnel.

(ii) According to AS 18 on 'Related Party Disclosures', parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Hence, Shri Bhanu, a relative of key management personnel should be identified as related party for disclosure in the financial statements for the year ended 31.3.2021 as he received remuneration for his services in the company for the period from 1st April,2020 to 30th June,2020.

## Question 27

(a) Omega Bank Limited holds 25 per cent of the voting power of B Limited. Omega Bank Limited also provides finance by way of a loan to B Limited at market rates of interest, on account of which, Omega Bank Limited would have the power to nominate one person to the board of directors of B Limited. Any major transactions proposed to be entered into by B Limited would need the consent of Omega Bank Limited. Would Omega Bank Limited be considered as related party for B Ltd. (reporting enterprise)?

(b) A Limited has two Associates, B Limited and C Limited, and owns 25 per cent of the voting power of B Limited and 30 per cent of the voting power of C Limited. Would B Limited be considered a related party for the purpose of financial statements of C Limited?

(*RTP November 2021*)

**Answer**

**(a)** Omega Bank Limited would be a related party of B Limited. As per AS 18 "associates and joint ventures of the reporting enterprise and the investing party of venture in respect of which the reporting enterprise is an associate or a joint venturer" are related party relationship. Further, an associate has been defined as "an enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of the party". Significant influence has been defined to be "participation in the financial and /or operating policy decisions of an enterprise, but not control of those policies". Further, it is given in the standard that significant influence may be gained by share ownership, agreement or statute. As regards share ownership, there is a presumption that ownership of 20 per cent or more of the voting power enables the enterprise to exercise significant influence, unless it could be clearly demonstrated otherwise. In the given example, Omega Bank Limited exercises significant influence over B Limited by virtue of ownership of 25 per cent of the voting power.

Omega Bank Limited is also a provider of finance for B Limited (as it has provided a loan to B Limited), and as per the standard, a provider of finance is deemed not to be a related party during its normal dealings with the enterprise by virtue only of those dealing. However, in this case, the exemption would not be available to Omega Bank Limited as the exercise of significant influence of Omega Bank Limited over B Limited has been demonstrated on account of ownership of more than 20 per cent of voting power. Accordingly, Omega Bank Limited would be construed to be a related party in the financial statements of B Limited and consequently, the latter would be required to disclose the transactions with Omega Bank Limited in its financial statements.

**(b)** Both B Limited and C Limited are 'associates' of A Limited. Follow-associates cannot be regarded as a related parties only by virtue of the relationship. AS 18 states that "enterprise that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise" are related parties. Further, it is given that "associates and joint ventures of the reporting enterprise and the investing party or venture in respect of which the reporting enterprise is an associate or a joint venturer" are also related parties. As B Limited is not an associate of C Limited, nor is it being controlled, directly or indirectly, by C Limited or is not so controlling C Limited, it is not a related party of C Limited.

## Question 28

(a) In respect of a key supplier who is dependent on the company for its existence and the company enjoys influence over the prices of this supplier (which may not be formally demonstrable), can the supplier and the company be considered as related parties?

(b) Define "Key management personnel" in the context of AS 18.

(*RTP May, 2022*)

**Answer**

**(a)** The supplier and the company cannot be considered to be related parties merely because the latter is able to influence the transaction price between the parties. Paragraph 3 of AS 18 states that "enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise" are considered to be related party relationships. However, the conditions which define the existence of control, as follows, are not satisfied in the given example.

- 'ownership, directly or indirectly, of more than one-half of the voting power of an enterprise, or
- Control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or
- a substantial interest in voting power and the power to direct, by statue or agreement, the financial and/or operating policies of the enterprise".

Paragraph 10 of the standard defines significant influence as "participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies". In the given example, although the supplier and the company have entered into a commercial transaction, the terms of which are influenced by the latter because of its better bargaining power in the specific market for such goods, it cannot be concluded that there is participation in the financial and/or operating policy decisions. Therefore, as the conditions specified by the Standard for being classified as a related party are not satisfied in the given example, the company cannot be said to be related to the supplier. This view is supported by paragraph 4(b) of the Standard which states that “a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence” would not be deemed to be related parties.

**(b)** In context of AS 18, “Key management personnel” are those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. For example, in the case of a company, the managing director(s), whole time director(s), manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.

## Question 29

SP hotels Limited enters into an agreement with Mr. A for running its hotel for a fixed return payable to the later every year. The contract involves the day-to-day management of the hotel, while all financial and operating policy decisions are taken by the Board of Directors of the company. Mr. A does not own any voting power in SP Hotels Limited. Would he be considered as a related party of SP Hotels Limited?

(*RTP November, 2022*)

**Answer**

Mr. A will not be considered as a related party of SP Hotels Limited in view of AS 18 which states, “individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual”. In the given case, in the absence of share ownership, Mr. A would not be considered to exercise significant influence on SP Hotels Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr. A does not have the ability to direct or instruct the board of directors does not qualify him as a key management personnel.

## Question 30

Is remuneration paid to Board of Directors a related party transaction? Explain.

(*RTP May, 2023*)

**Answer**

In case of a Company, the Managing Director, whole time director, manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered Key Managerial Personnel (KMP).

Persons who do not have the authority and responsibility for planning, directing and controlling the activities of the enterprise would not be KMP. Conversely, persons without any formal titles may be considered to be KMP, if they plan, direct and control the activities of the enterprise.

Further, as per Companies Act, 2013, a related party includes a director or his relative. The Act, defines a director as a director appointed to the Board of a Company.

**Hence, remuneration paid to Board of Directors will be considered as related party transaction.**

## Question 31

Answer the following with respect to AS-18

(i) ABC Ltd. sold goods of ₹2,00,000 to its associate company for the 1st quarter ending 30.06.2022. After that the related party relationship ceased to exist. However, goods were supplied to any other ordinary customer. Decide whether transactions of the entire year have to be disclosed as related party transaction.

(ii) If the majority of directors of Arjun Ltd. constitute the' majority of the Board of another Company Bheem Ltd. in their individual capacity as professionals (and not by virtue of their being Directors in Arjun Ltd.). Are both the companies related?

(iii) Asha Ltd. sells all the manufactured furniture of ₹1,00,00,000 to Sasha Ltd. as per agreement. Sasha Ltd. is the only customer to. Asha Ltd. In the financial statements, Asha Ltd. wants to. present Sasha company as a related party. Comment on the disclosure requirement.

(*G-II, May, 2023*) (*5 Marks*)

CHAPTER 8

# Accounting Standard 20 Earnings Per Share

## Question 1

| *Date* | *Particulars* | | | *Balance* |
|---|---|---|---|---|
| *1st January* | *Balance at beginning of year* | *1,800* | *-* | *1,800* |
| *31st May* | *Issue of shares for cash* | *600* | *-* | *2,400* |
| *1st November* | *Buy Back of shares* | *-* | *300* | *2,100* |

*Calculate Weighted Number of Shares.*

(*Source: Illustration 1, Study Material*)

**Answer**

Computation of Weighted Average:

(1,800 x 5/12) + (2,400 x 5/12) + (2,100 x 2/12) = 2,100 shares.

The weighted average number of shares can alternatively be computed as follows: (1,800 x12/12) + (600 x 7/12) - (300 x 2/12) = 2,100 shares

In most cases, shares are included in the weighted average number of shares from the date the consideration is receivable, for example:

a. Equity shares issued in exchange for cash are included when cash is receivable;
b. Equity shares issued as a result of the conversion of a debt instrument to equity shares are included as of the date of conversion;
c. Equity shares issued in lieu of interest or principal on other financial instruments are included as of the date interest ceases to accrue;
d. Equity shares issued in exchange for the settlement of a liability of the enterprise are included as of the date the settlement becomes effective;
e. Equity shares issued as consideration for the acquisition of an asset other than cash are included as of the date on which the acquisition is recognised; and
f. Equity shares issued for the rendering of services to the enterprise are included as the services are rendered.

In these and other cases, the timing of the inclusion of equity shares is determined by the specific terms and conditions attaching to their issue. Due consideration should be given to the substance of any contract associated with the issue.

## Question 2

| *Date* | *Particulars* | *No. of Shares* | *Face Value* | *Paid up Value* |
|---|---|---|---|---|
| *1st January* | *Balance at beginning of year* | *1,800* | *₹10* | *₹10* |
| *31st October* | *Issue of Shares* | *600* | *₹10* | *₹5* |

*Calculate Weighted Number of Shares.*

(*Source: Illustration 2, Study Material*)

**Answer**

Assuming that partly paid shares are entitled to participate in the dividend to the extent of amount paid, number of partly paid equity shares would be taken as 300 for the purpose of calculation of earnings per share.

Computation of weighted average would be as follows:

(1,800 x 12/12) + (300 x 2/12) = 1,850 shares.

Where an enterprise has equity shares of **different nominal values** but with the same dividend rights, the number of equity shares is calculated by converting all such equity shares into equivalent number of shares of the same nominal value.

**Contingently Issuable Shares**

Equity shares which are issuable upon the satisfaction of certain conditions resulting from contractual arrangements (contingently issuable shares) are considered outstanding, and included in the computation of basic earnings per share from the date when all necessary conditions under the contract have been satisfied.

**Bonus Issue, Share split and Right issue**

Equity shares may be issued, or the number of shares outstanding may be reduced, without a corresponding change in resources. Examples include:

a. A bonus issue;

b. A bonus element in any other issue, for example a bonus element in a rights issue to existing shareholders;

c. A share split; and

d. A reverse share split (consolidation of shares).

In case of a **bonus issue or a share split,** equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. The number of equity shares outstanding before the event is adjusted for the proportionate change in the number of equity shares outstanding as if the event had occurred at the beginning of the earliest period reported means along with the impact to current year adjustment, **it will also impact the calculation of EPS of last year retrospectively.**

For example, upon a two-for-one bonus issue, the number of shares outstanding prior to the issue is multiplied by a factor of three to obtain the new total number of shares, or by a factor of two to obtain the number of additional shares.

## Question 3

| | |
|---|---|
| *Net profit for the year 20X1* | *₹18,00,000* |
| *Net profit for the year 20X2* | *₹60,00,000* |
| *No. of equity shares outstanding until 30th September 20X2* | *20,00,000* |

*Bonus issue 1st October 20X2 was 2 equity shares for each equity share outstanding at 30th September, 20X2*

*Calculate Basic Earnings Per Share.*

(*Source: Illustration 3, Study Material*)

**Answer**

No. of Bonus Issue 20,00,000 x 2 = 40,00,000 shares

$$\text{Earnings per share for the year 20X2} \quad \frac{₹60,00,000}{₹20,00,000 + 40,00,000} = ₹1.00$$

$$\text{Adjusted earnings per share for the year 20X1} \quad \frac{₹18,00,000}{₹20,00,000 + 40,00,000} = ₹0.30$$

Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 20X1, the earliest period reported.

The issue of equity shares at the time of exercise or conversion of potential equity shares will not usually give rise to a bonus element, since the potential equity shares will usually have been issued for full value, resulting in a proportionate change in the resources available to the enterprise. In a **rights issue**, on the other hand, the **exercise price is often less than the fair value of the shares**. Therefore, a rights issue usually includes a bonus element.

[Thus, it may be noted that if a company makes a right issue at fair value itself, then there will be no bonus element in the right issue].

The number of equity shares to be used in calculating basic earnings per share for all periods prior to the rights issue is the number of equity shares outstanding prior to the issue, multiplied by the following adjustment factor:

$$\frac{\text{Fair value per share immediately prior to the exercise of rights}}{\text{Theoretical ex-rights fair value per share}}$$

The theoretical ex-rights fair value per share is calculated by adding the aggregate fair value of the shares immediately prior to the exercise of the rights to the proceeds from the exercise of the rights, and dividing by the number of shares outstanding after the exercise of the rights.

## Question 4

| | |
|---|---|
| *Net profit for the year 20X1* | *₹11,00,000* |
| *Net profit for the year 20X2* | *₹15,00,000* |
| *No. of shares outstanding prior to rights issue* | *5,00,000* |
| *shares Rights issue price* | *₹15.00* |
| *Last date to exercise rights* | *1st March 20X2* |

*Rights issue is one new share for each five outstanding (i.e. 1,00,000 new shares)*

*Fair value of one equity share immediately prior to exercise of rights on 1st March 20X2 was ₹21.00. Compute Basic Earnings Per Share.*

(*Source: Illustration 4, Study Material*)

**Answer**

$$\frac{\text{Fair value of shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise +Number of shares issued in the exercise}}$$

$$\frac{(₹21.00 \times 5,00,000 \text{ shares}) + (₹15.00 \times 1,00,000 \text{ Shares})}{5,00,000 \text{ Shares} + 1,00,000 \text{ Shares}}$$

Theoretical ex-rights fair value per share = ₹20.00

*Computation of adjustment factor:*

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}} \quad \frac{₹(21.00)}{₹(20.00)} = 1.05$$

*Computation of earnings per share:*

EPS for the year 20X1 as originally reported: ₹11,00,000/5,00,000 shares = ₹2.20

EPS for the year 20X1 restated for rights issue: ₹11,00,000/ (5,00,000 shares x 1.05) = ₹2.10

EPS for the year 20X2 including effects of rights issue:

(5,00,000 x 1.05 x 2/12) + (6,00,000 x 10/12) = 5,87,500 shares

EPS = 15,00,000/5,87,500 = ₹2.55

## Question 5

| | |
|---|---|
| *Net profit for the current year* | *₹1,00,00,000* |
| *No. of equity shares outstanding* | *50,00,000* |
| *Basic earnings per share* | *₹2.00* |

| | |
|---|---|
| *No. of 12% convertible debentures of ₹100 each* | *1,00,000* |
| *Each debenture is convertible into 10 equity shares* | |
| *Interest expense for the current year* | *₹12,00,000* |
| *Tax relating to interest expense (30%)* | *₹3,60,000* |

*Compute Diluted Earnings Per Share.*

(*Source: Illustration 5, Study Material*)

**Answer**

Adjusted net profit for the current year (1,00,00,000 + 12,00,000 – 3,60,000) = ₹1,08,40,000

No. of equity shares resulting from conversion of debentures: 10,00,000 Shares No. of equity shares used to compute diluted EPS: (50,00,000 + 10,00,000) = 60,00,000 Shares

Diluted earnings per share: (1,08,40,000/60,00,000) = ₹1.81

## Question 6

| | |
|---|---|
| *Net profit for the year 20X1* | *₹12,00,000* |
| *Weighted average number of equity shares outstanding during the year 20X1* | *5,00,000 shares* |
| *Average fair value of one equity share during the year 20X1* | *₹20.00* |
| *Weighted average number of shares under option during the year 20X1* | *1,00,000 shares* |
| *Exercise price for shares under option during the year 20X1* | *₹15.00* |

*Compute Basic and Diluted Earnings Per Share.*

(*Source: Illustration 6, Study Material*)

**Answer**

**Computation of earnings per share**

| | ***Earnings*** ₹ | ***Shares*** | ***Earnings/Share*** ₹ |
|---|---|---|---|
| Net profit for the year 20X1 | 12,00,000 | | |
| Weighted average no. of shares during year 20X1 | | 5,00,000 | |
| Basic earnings per share | | | 2.40 |
| Number of shares under option | | 1,00,000 | |
| Number of shares that would have been issued at | | | |
| fair value (100,000 x 15.00)/20.00 | — | (75,000) | |
| Diluted earnings per share | 12,00,000 | 5,25,000 | 2.29 |

**Note:** The earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of the computation to have been issued for no consideration.

## Question 7

*X Limited, during the year ended March 31, 20X1, has income from continuing ordinary operations of ₹ 2,40,000, a loss from discontinuing operations of ₹ 3,60,000 and accordingly a net loss of ₹ 1,20,000. The Company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 20X1.*

*You are required to compute Basic and Diluted EPS?*

(*Source: Illustration 7, Study Material*)

**Answer**

As per AS 20 “Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations”.

As income from continuing ordinary operations, ₹ 2,40,000 would be considered and not ₹ (1,20,000), for ascertaining whether 200 potential equity shares are dilutive or anti-dilutive. Accordingly, 200 potential equity shares would be dilutive potential equity shares since their inclusion would decrease the net profit per share from continuing ordinary operations from ₹ 240 to ₹ 200. Thus, the basic E.P.S would be ₹ (120) and diluted E.P.S. would be ₹ (100).

**In case there are more than 1 potential equity shares:**

In considering whether potential equity shares are dilutive or antidilutive, each issue or series of potential equity shares is considered separately rather than in aggregate. The sequence in which potential equity shares are considered may affect whether or not they are dilutive. Therefore, in order to maximise the dilution of basic earnings per share, each issue or series of potential equity shares is considered in sequence from the most dilutive to the least dilutive. For the purpose of determining the sequence from most dilutive to least dilutive potential equity shares, the earnings per incremental potential equity share is calculated. Where the earnings per incremental share is the least, the potential equity share is considered most dilutive and vice-versa.

## Question 8

*In the following list of shares issued, for the purpose of calculation of weighted average number of shares, from which date weight is to be considered:*

*(i)* *Equity Shares issued in exchange of cash,*

*(ii)* *Equity Shares issued as a result of conversion of a debt instrument,*

*(iii)* *Equity Shares issued in exchange for the settlement of a liability of the enterprise,*

*(iv)* *Equity Shares issued for rendering of services to the enterprise,*

*(v)* *Equity Shares issued in lieu of interest and/or principal of another financial instrument,*

*(vi)* *Equity Shares issued as consideration for the acquisition of an asset other than in cash.*

*Also define Potential Equity Share.*

(*Source: Question 6, Study Material*)

**Answer**

The following dates should be considered for consideration of weights for the purpose of calculation of weighted average number of shares in the given cases:

(i) Date of Cash receivable

(ii) Date of conversion

(iii) Date on which settlement becomes effective

(iv) When the services are rendered

(v) Date when interest ceases to accrue

(vi) Date on which the acquisition is recognised.

A Potential Equity Share is a financial instrument or other contract that entitles or may entitle its holder to equity shares.

## Question 9

*Stock options have been granted by AB Limited to its employees and they vest equally over 5 years, i.e., 20 per cent at the end of each year from the date of grant. The options will vest only if the employee is still employed with the company at the end of the year. If the employee leaves the company during the vesting period, the options that have vested can be exercised, while the others would lapse. Currently, AB Limited includes only the vested options for calculating Diluted EPS.*

*Should only completely vested options be included for computation of Diluted EPS? Is this in accordance with the provisions of AS 20? Explain.*

(*Source: Question 7, Study Material*)

**Answer**

As per AS 20 "A potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares".

Options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans are examples of potential equity shares. Further, for the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.

The current method of calculating Diluted EPS adopted by AB limited is not in accordance with AS 20. The calculation of Diluted EPS should include all potential equity shares, i.e., all the stock options granted at the balance sheet date, which are dilutive in nature, irrespective of the vesting pattern. The options that have lapsed during the year should be included for the portion of the period the same were outstanding, pursuant to the requirement of the standard.

## Question 10

*Explain why the bonus issue of shares and the shares issue at full market price are treated differently in the calculation of the basic earnings per share?*

(*Source: Question 8, Study Material*)

In case of a bonus issue, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. Since the bonus issue is an issue without consideration, *the issue is treated as if it had occurred prior to the beginning of the earliest period reported.*

However, the share issued at full market price does not carry any bonus element and usually results in a proportionate change in the resources available to the enterprise. Therefore, it is taken into consideration from the time it has been issued i.e. the time- weighting factor is considered based on the specific shares outstanding as a proportion of the total number of days in the period.

## Question 11

*NAT, a listed entity, as on 1st April, 20X1 had the following capital structure:*

| ***Particulars*** | ***₹*** |
|---|---|
| *10,00,000 Equity Shares having face value of ₹1 each* | *10,00,000* |
| *10,00,000 8% Preference Shares having face value of ₹10 each* | *1,00,00,000* |

*During the year 20X1-20X2, the company had profit after tax of ₹ 90,00,000.*

*On 1st January, 20X2, NAT made a bonus issue of one equity share for every 2 equity shares outstanding as at 31st December, 20X1.*

*On 1st January, 20X2, NAT issued 2,00,000 equity shares of ₹ 1 each at their full market price of ₹ 7.60 per share.*

*NAT's shares were trading at ₹ 8.05 per share on 31st March, 20X2.*

*Further it has been provided that the basic earnings per share for the year ended 31st March, 20X1 was previously reported at ₹ 62.30.*

***You are required to:***

(i) *Calculate the basic earnings per share to be reported in the financial statements of NAT for the year ended 31st March, 20X2 including the comparative figure, in accordance with AS-20 Earnings Per Share.*

(ii) *Explain why the bonus issue of shares and the shares issue at full market price are treated differently in the calculation of the basic earnings per share?*

(*Source: Question 9, Study Material*)

**Answer**

**(i) Computation of Basic Earnings per share for the year ended 31st** March, 20X2:

**(including the comparative figure)**

**Working Note – I:**

**Earnings for the year ended 31st March, 20X1:**

= EPS x Number of shares outstanding during 20X0-20X1

= ₹62.30 x 10,00,000 equity shares

= ₹6,23,00,000

**Adjusted/Restated Earnings per share for the year ended 31st March 20X1:**

**(after taking into consideration bonus issue) Adjusted/Restated Basic EPS:**

= Earnings for the year 20X0-20X1 / (Total outstanding shares +Bonus issue)

= ₹6,23,00,000 / (10,00,000+ 5,00,000)

= ₹6,23,00,000 / 15,00,000

= ₹41.53 per share

**Computation of Basic EPS for the year 20X1-20X2:**

Basic EPS = (Total Earnings – Preference Shares Dividend) / (Total shares outstanding at the beginning + Bonus issue + weighted average of the shares issued in January, 20X2)

= (₹90,00,000 – ₹(1,00,00,000 x 8%)) / (10,00,000 + 5,00,000 + (2,00,000 x 3/12))

= ₹82,00,000 / 15,50,000 shares

= ₹5.29 per share

(ii) In case of a bonus issue, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. Since the bonus issue is an issue without consideration, *the issue is treated as if it had occurred prior to the beginning of the year 20X1, the earliest period reported.*

However, the share issued at full market price does not carry any bonus element and usually results in a proportionate change in the resources available to the enterprise. Therefore, it is taken into consideration from the time it has been issued i.e. the time- weighting factor is considered based on the specific shares outstanding as a proportion of the total number of days in the period.

## Question 12

*X Ltd. supplied the following information. You are required to compute the basic earnings per share:*

| *(Accounting year 1.1.20X1 – 31.12.20X1)* | | |
|---|---|---|
| *Net Profit* | : | *Year 20X1: ₹20,00,000* |
| | : | *Year 20X2: ₹30,00,000* |
| *No. of shares outstanding prior to Right Issue* | : | *10,00,000 shares* |
| *Right Issue* | : | *One new share for each four outstanding i.e., 2,50,000 shares.* |
| | | *Right Issue price – ₹20* |
| | | *Last date of exercise rights – 31.3.20X2.* |
| *Fair rate of one Equity share immediately prior to exercise of rights on 31.3.20X2* | : | *₹25* |

(*Source: Question 10, Study Material*)

**Answer**

**Computation of Basic Earnings Per Share**

**(as per paragraphs 10 and 26 of AS 20 on Earnings Per Share)**

| | ***Year 20X1*** ₹ | ***Year 20X1*** ₹ |
|---|---|---|
| *EPS for the year 20X1 as originally reported* | | |
| $\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$ | | |
| = (₹20,00,000 / 10,00,000 shares) | 2.00 | |
| *EPS for the year 20X1 restated for rights issue* | | |
| = [₹20,00,000 / (10,00,000 shares ₹1.04[1])] | 1.91 (approx.) | |
| *EPS for the year 20X2 including effects of rights issue* | | |
| $\frac{₹30,00,000}{(10,00,000\text{shares} \times 1.04 \times 3/12) + (12,50,000 \text{ shares} \times 9/12)}$ | | |
| $\frac{₹30,00,000}{11,97,500 \text{ shares}}$ | | 2.51 (approx.) |

1 Refer working note 2.

**Working Notes:**

1. Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise+ Number of shares issued in the exercise}}$$

$$= \frac{(₹25 \times 10,00,000 \text{ shares}) + (₹20 \times 2,50,000) \text{ shares}}{10,00,000 \text{ shares} + 2,50,000 \text{ shares}} = \frac{₹30,000,000}{\text{shares } 000,50,12} ₹24$$

2. Computation of adjustment factor

$$= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}}$$

$$= \frac{₹25}{₹24 \text{ (Refer Working Note 1)}} = 1.04 \text{ (approx.)}$$

## Question 13

*On 1st April, 20X1 a company had 6,00,000 equity shares of ₹10 each (₹5 paid up by all shareholders). On 1st September, 20X1 the remaining ₹5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 20X2 was ₹21,96,000 after considering dividend on preference shares of ₹3,40,000.*

*You are required to compute Basic EPS for the year ended 31st March, 20X2 as per Accounting Standard 20 "Earnings Per Share".*

(*Source: Question 11, Study Material*)

**Answer**

**11.** Basic Earnings per share (EPS) =

$$\frac{\text{Weighted average number of equity shares outstanding during the year}}{\text{Theoretical ex-rights value per share}}$$

$$= \frac{21,96,000}{4,57,500 \text{ Shares (as per working note)}} = ₹4.80 \text{ per share}$$

**Working Note:**

Calculation of weighted average number of equity shares

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

| ***Date*** | ***No. of equity shares*** | ***Amount paid per share*** | ***Weighted average no. of equity shares*** |
|---|---|---|---|
| | ₹ | ₹ | ₹ |
| 1.4.20X1 | 6,00,000 | 5 | 6,00,000 x 5/10 x 5/12 = 1,25,000 |
| 1.9.20X1 | 5,40,000 | 10 | 5,40,000 x 7/12 = 3,15,000 |
| 1.9.20X1 | 60,000 | 5 | 60,000 x 5/10 x 7/12 = <u>17,500</u> |
| Total weighted average equity shares | | | <u>4,57,500</u> |

## Question 14

*No. of equity shares outstanding = 30,00,000 Basic earnings per share ₹5.00*

*No. of 12% convertible debentures of ₹100 each; 50,000 Each debenture is convertible into 10 equity shares*

*Tax Rate 30%*

*Compute Diluted Earnings per Share.*

*Working notes should form part of the answer.*

(*Source: Question 12, Study Material*)

**Answer**

Basic Earnings per share (EPS) =

$$\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{21,96,000}{\text{4,57,500 Shares (as per working note)}} = ₹4.80 \text{ per share}$$

$$□ \frac{21,96,000}{\text{4,57,500 Shares (as per working note)}}$$

**Working Note:**

Calculation of weighted average number of equity shares

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

| ***Date*** | ***No. of equity shares*** | ***Amount paid per share*** | ***Weighted average no. of equity shares*** |
|---|---|---|---|
| | ₹ | ₹ | ₹ |
| 1.4.20X1 | 6,00,000 | 5 | 6,00,000 x 5/10 x 5/12 = 1,25,000 |
| 1.9.20X1 | 5,40,000 | 10 | 5,40,000 x 7/12 = 3,15,000 |
| 1.9.20X1 | 60,000 | 5 | 60,000 x 5/10 x 7/12 = <u>17,500</u> |
| Total weighted average equity shares | | | <u>4,57,500</u> |

# QUESTION BANK

## Question 15

In the following list of shares issued, for the purpose of calculation of weighted average number of shares, from which date weight is to be considered:

(i) Equity Shares issued in exchange of cash,

(ii) Equity Shares issued as a result of conversion of a debt instrument,

(iii) Equity Shares issued in exchange for the settlement of a liability of the enterprise,

(iv) Equity Shares issued for rendering of services to the enterprise,

(v) Equity Shares issued in lieu of interest and/or principal of another financial instrument,

(vi) Equity Shares issued as consideration for the acquisition of an asset other than in cash.

Also define Potential Equity Share.

(*November 2014, 4 Marks*)

## Question 16

M/s. A Ltd. had 8,00,000 Equity Shares outstanding on 1st April, 2013. The Company earned a profit of ₹20,00,000 during the year 2013-14. The average fair value per share during 2013-14 was ₹40. The Company has given Share Option to its employees of 1,00,000 Equity Shares at option price of ₹20.

Calculate Basic EPS and Diluted EPS.

(*May, 2015, 5 Marks*)

**Answer**

**Computation of Earnings Per Share**

| | *Earnings* ₹ | *Shares* | *Earnings per share* ₹ |
|---|---|---|---|
| Net Profit for the year 2013-14 | 20,00,000 | | |
| Number of shares outstanding during the year 2013-14 | | 8,00,000 | |
| **Basic Earnings Per Share** $= \frac{20,00,000}{8,00,000}$ | | | 2.50 |
| Number of shares under option | | 1,00,000 | |
| Number of shares that would have been issued at fair value (Refer Note) [1,00,000 x 20/40] | | (50,000) | |
| **Diluted Earnings Per Share** $= \frac{20,00,000}{8,50,000}$ | 20,00,000 | 8,50,000 | 2.35 |

**Note:**

The earnings have not been increased as the total number of shares has been increased only by the number of shares (50,000) deemed for the purpose of the computation to have been issued for no consideration.

## Question 17

What do you mean by "Weighted average number of equity shares outstanding during the period" and why is it required to be calculated? Compute weighted average number of equity shares in the following case:

| | | **No. of shares** |
|---|---|---|
| 1st April, 2014 | Balance of Equity Shares | 5,00,000 |
| 30th June, 2014 | Equity Shares issued for cash | 1,00,000 |
| 15th January, 2015 | Equity Shares bought back | 50,000 |
| 31st March, 2015 | Balance of Equity Shares | 5,50,000 |

(*November 2015, 4 Marks*)

**Answer**

As per AS 20, "Earnings Per Share", the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or lesser number of shares outstanding at any time.

For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

**Computation of weighted average number of shares outstanding during the period**

| Date | No. of equity shares | Period outstanding | Weights (months) | Weighted average number of shares |
|---|---|---|---|---|
| (1) | (2) | (3) | (4) | (5) = (2) x (4) |
| 1st April, 2014 | 5,00,000 (Opening) | 3 months | 3 /12 | 1,25,000 |
| 30th June 2014 | 6,00,000 (after Additional issue) | 6.5 months | 6.5/12 | 3,25,000 |
| 15th Jan, 2015 | 5,50,000 (after Buy back) | 2.5 months | 2.5/12 | 1,14,583 |
| 31st March, 2015 | 5,50,000 (Balance) | 0 month | 0/12 | - |
| Total | | | | 5,64,583 |

## Question 18

"While calculating diluted EPS, effect is given to all dilutive potential equity shares that were outstanding during the period." Explain this statement in the light of relevant AS.

Also calculate the diluted EPS from the following information:

| | |
|---|---|
| Net Profit for the current year (After Tax) | ₹1,00,00,000 |
| No. of Equity shares outstanding | 10,00,000 |
| No. of 10% Fully Convertible Debentures of ₹100 each | 1,00,000 |
| (Each Debentures is compulsorily & fully convertible into 10 equity shares) | |
| Debenture interest expense for the current year | ₹5,00,000 |
| Assume applicable Income Tax rate @ 30% | |

(*November, 2016, 5 Marks*)

**Answer**

As per AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares for calculation of diluted earnings per share. Hence, "in calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period."

Computation of diluted earnings per share = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

**Adjusted net profit for the current year**

| | ₹ |
|---|---|
| Net profit for the current year (after tax) | 1,00,00,000 |
| *Add*: Interest expense for the current year | 5,00,000 |
| *Less*: Tax relating to interest expense (30% of ₹5,00,000) | (1,50,000) |
| Adjusted net profit for the current year | 1,03,50,000 |

Weighted average number of equity shares

Number of equity shares resulting from conversion of debentures

$= \frac{1,00,000 \times 100}{10}$ = 10,00,000 Equity shares

**Weighted average number of equity shares used to compute diluted earnings per share**

= [(10,00,000 x 12) + (10,00,000 x 6)]/12 = 15,00,000 equity shares

Diluted earnings per share = ₹1,03,50,000 / 15,00,000 shares = ₹6.90 per share

**Note:** Interest on debentures for full year amounts to ₹10,00,000 (i.e. 10% of ₹1,00,00,000). However, interest expense amounting ₹5,00,000 has been given in the question. It may be concluded that debentures have been issued at the mid of the year and interest has been provided for 6 months.

## Question 19

From the following information, you are required to compute the basic and adjusted Earnings per share:

| | |
|---|---|
| Net profit for 2015-16 | 11 lakh |
| Net profit for 2016-17 | 15 lakh |
| No. of shares issued before rights issue | 5 lakhs |
| Right issue | One for every 5 held |
| Right issue price | 15 per share |
| Last date of exercising right option | 1-06-2016 |
| Fair value of shares before right issue | 21 per share |

*(MTP March 2018/MTP-March 2019) (5 Marks)*

**Answer*:***

Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + Total amount received from exercise of rights}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

$$\frac{(₹\ 21.00 \times 5{,}00{,}000\text{shares}) + (₹15.00 \times 1{,}00{,}000\text{shares})}{5{,}00{,}000\text{shares} + 1{,}00{,}000\text{shares}}$$

Theoretical ex-rights fair value per share = ₹20.00

(a) Computation of adjustment factor

$$\frac{\text{Fair value per share prior b exercise of rights}}{\text{Theorelica lex - righte value per share}} = \frac{\text{Rs. }(21.00)}{\text{Rs. }(20.00)} = 1.05$$

Computation of earnings per share

| | Year 2015-16 | Year 2016-17 |
|---|---|---|
| EPS for the year 2015-16 as originally reported: (₹11,00,000/5,00,000 shares) | ₹2.20 | |
| EPS for the year 2015-16 restated for rights issue: [₹11,00,000/(5,00,000 shares x 1.05)] | ₹2.10 | |
| EPS for the year 2016-17 including effects of rights issue $\frac{\text{Rs. }15{,}00{,}000}{(5{,}00{,}000 \times 1.05 \times 2/12) + (6{,}00{,}000 \times 10/12)}$ | | ₹2.55 |

## Question 20

As at 1st April, 2016 a company had 6,00,000 equity shares of ₹10 each (₹5 paid up by all shareholders). On 1st September, 2016 the remaining ₹5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 2017 was ₹21,96,000 after considering dividend on preference shares and dividend distribution tax on such dividend totalling to ₹3,40,000.

Compute Basic EPS for the year ended 31st March, 2017 as per Accounting Standard 20 "Earnings Per Share".

*(May 2018) (5 Marks)*

**Answer:**

**Basic Earnings per share (EPS)** =

$$\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{21{,}96{,}000}{4{,}57{,}500 \text{ Shares (as per working note)}} = \text{Rs. 4.80 per share}$$

**Working Note:**

**Calculation of weighted average number of equity shares**

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

| Date | No. of equity shares | Amount paid per share | Weighted average no. of equity shares |
|---|---|---|---|
| | ₹ | ₹ | ₹ |
| 1.4.2016 | 6,00,000 | 5 | 6,00,000x5/10x5/12 = 1,25,000 |
| 1.9.2016 | 5,40,000 | 10 | 5,40,000 x 7/12 = 3,15,000 |
| 1.9.2016 | 60,000 | 5 | 60,000x5/10x7/12 = 17,500 |
| Total weighted average equity shares | | | 4,57,500 |

## Question 21

The following information relates to M/s. XYZ Limited for the year ended 31st March, 2017:

| | |
|---|---|
| Net Profit for the year after tax: | ₹75,00,000 |
| Number of Equity Shares of ₹10 each outstanding: | ₹10,00,000 |

Convertible Debentures Issued by the Company (at the beginning of the year)

| **Particulars** | **Nos.** |
|---|---|
| 8% Convertible Debentures of ₹100 each | 1,00,000 |
| Equity Shares to be issued on conversion | 1,10,000 |

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

(*RTP May 2018*)

**Answer:**

**Computation of basic earnings per share**

Net profit for the current year/Weighted average number of equity shares outstanding during the year

₹75,00,000/10,00,000 = ₹7.50 per share

**Computation of diluted earnings per share** $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

**Adjusted net profit for the current year**

| | ₹ |
|---|---|
| Net profit for the current year | 75,00,000 |
| Add: Interest expense for the current year | 8,00,000 |
| Less: Tax relating to interest expense (30% of ₹8,00,000) | 8,00,000 |
| Adjusted net profit for the current year | 80,60,000 |

**Number of equity shares resulting from conversion of debentures**

= 1,10,000 Equity shares (given in the question)

**Weighted average number of equity shares used to compute diluted earnings per share**

= 11,10,000 shares (10,00,000 + 1,10,000)

**Diluted earnings per share**

= 80,60,000/11,10,000 = ₹7.26 per share

**Note**: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

## Question 22

The following information is available for TON Ltd. for the accounting year 2015-16 and 2016-17:

| | **Net profit for** | **₹** |
|---|---|---|
| Year | 2015-16 | 35,00,000 |
| Year | 2016-17 | 45,00,000 |

No of shares outstanding prior to right issue 15,00,000 shares.

Right issue : One new share for each 3 shares outstanding i.e. 5,00,000 shares.
: Right Issue price ₹25
: Last date to exercise rights 31st July, 2016

Fair value of one equity share immediately prior to exercise of rights on 31.07.2016 is ₹35.

You are required to compute:

(i) Basic earnings per share for the year 2015-16.
(ii) Restated basic earnings per share for the year 2015-16 for right issue.
(iii) Basic earnings per share for the year 2016-17.

(*RTP November 2018*)

**Answer: Computation of Basic Earnings per Share**

| | | Year 2015-16 (₹) | Year 2016-17 (₹) |
|---|---|---|---|
| (i) | EPS for the year 2015-16 as originally reported = Net profit for the year attributable to equity share holder/weighted average number of equity shares outstanding during the year ₹35,00,000/15,00,000 shares | 2.33 | |
| (ii) | EPS for the year 2015-16 restated for the right issue ₹35,00,000/15,00,0000 shares × 1.08 | 2.16 | |
| (iii) | EPS for the year 2016-17 (including effect of right issue) ₹45,00,000/[(15,00,000 × 1.08 × 4/12) + (20,00,000 × 8/12)] | | 2.40 |

**Working Notes:**

1. Computation of theoretical ex-rights fair value per share =

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

[(₹35 × 15,00,000) + [₹25 × 5,00,000)]/(15,00,000 + 5,00,000) = ₹32.5

2. **Computation of adjustment factor**

Fair value per share prior to exercise of rights Theoretical ex-rights value per share
= ₹35/32.50 = 1.08 (approx.)

## Question 23

The following information relates to M/s. XYZ Limited for the year ended 31st March, 2017:

Net Profit for the year after tax: ₹75,00,000

Number of Equity Shares of ₹10 each outstanding: 10,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

| Particulars | Nos. |
|---|---|
| 8% Convertible Debentures of ₹100 each | 1,00,000 |
| Equity Shares to be issued on conversion | 1,10,000 |

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

(*MTP October 2018*) (*5 Marks*)

**Answer:**

**Computation of basic earnings per share**

Net profit for the current year/Weighted average number of equity shares outstanding during the year

₹75,00,000/10,00,000 = ₹7.50 per share

**Computation of diluted earnings per share**

$$\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$$

**Adjusted net profit for the current year**

| | ₹ |
|---|---|
| Net profit for the current year | 75,00,000 |
| *Add*: Interest expense for the current year | 8,00,000 |
| *Less*: Tax relating to interest expense (30% of ₹8,00,000) | (2,40,000) |
| Adjusted net profit for the current year | 80,60,000 |

**Number of equity shares resulting from conversion of debentures**

= 1,10,000 Equity shares (given in the question)

**Weighted average number of equity shares used to compute diluted earnings per share**

= 11,10,000 shares (10,00,000 + 1,10,000)

**Diluted earnings per share**

= 80,60,000/11,10,000 = ₹7.26 per share

**Note:** Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

## Question 24

The following information relates to M/s. XYZ Limited for the year ended 31st March, 2019: Net Profit for the year after tax: ₹37,50,000

Number of Equity Shares of ₹10 each outstanding: ₹5,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

| Particulars | Nos. |
|---|---|
| 8% Convertible Debentures of ₹100 each | 50,000 |
| Equity Shares to be issued on conversion | 55,000 |

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

(*RTP November 2019*)

**Answer:**

**Computation of basic earnings per share**

Net profit for the current year/Weighted average number of equity shares outstanding during the year ₹37,50,000/ 5,00,000 = ₹7.50 per share

$$\text{Computation of diluted earnings per share } \frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$$

**Adjusted net profit for the current year**

| | ₹ |
|---|---:|
| Net profit for the current year | 37,50,000 |
| *Add*: Interest expense for the current year | 4,00,000 |
| *Less*: Tax relating to interest expense (30% of ₹4,00,000) | (1,20,000) |
| Adjusted net profit for the current year | 40,30,000 |

**Number of equity shares resulting from conversion of debentures**

= 55,000 Equity shares (given in the question)

**Weighted average number of equity shares used to compute diluted earnings per share**

= 5,55,000 shares (5,00,000 + 55,000)

**Diluted earnings per share**

= 40,30,000/ 5,55,000 = ₹7.26 per share

*Note:* Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

## Question 25

Following information is supplied by K Ltd.

Number of shares outstanding prior to right issue - 2,50,000 shares.

Right issue - two new share for each 5 outstanding shares (i.e. 1,00,000 new shares)

Right issue price - ₹98

Last date of exercising rights - 30-06-2018.

Fair value of one equity share immediately prior to exercise of right on 30-06-2018 is ₹102.

Net Profit to equity shareholders:

2017-2018 – ₹50,00,000

2018-2019 – ₹75,00,000

You are required to calculate the basic earnings per share as per AS-20 Earning per Share.

(*November 2019, New Course, 5 Marks*)

**Answer:**

$$\frac{\text{Fair value of shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the exercise}}$$

$$\frac{102 \text{ x } 2,50,000 \text{ Shares} + ₹98 \times 1,00,000 \text{ shares}}{3,50,000 \text{ shares}}$$

Theoretical ex-rights fair value per share = ₹100.86

Computation of adjustment factor:

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}} = 102 / 100.86 = 1.01$$

**Computation of earnings per share:**

EPS for the year 2017-18 as originally reported: ₹50,00,000/2,50,000 shares = ₹20

EPS for the year 2017-18 restated for rights issue: =₹50,00,000/ (2,50,000 shares x 1.01)

= ₹19.80

EPS for the year 2018-19 including effects of rights issue:

EPS = 75,00,000/3,25,625* = ₹23.03

** [(2,50,000 x 1.01 x 3/12) + (3,50,000 x 9/12)] = 63,125 + 2,62,500 = 3,25,625 shares*

**Note**: Financial year (ended 31st March) is considered as accounting year while giving the above answer.

## Question 26

| | |
|---|---|
| Net Profit for financial year 2018-2019 | 30,00,000 |
| Net Profit for financial year 2019-2020 | 50,00,000 |
| No. of shares outstanding prior to rights issue | 20,00,000 shares |
| Rights Issue Price | ₹20 |
| Last day to exercise rights | 1st June, 2019 |

Right issue is one new share for each five equity share outstanding (i.e. 4,00,000 new shares).

Fair value of one equity share immediately prior to exercise of rights on 1st June, 2019 was ₹26.00.

Compute Basic Earnings Per Share for financial year 2018-19, 2019-2020 and restated EPS for 2018-19.

(*MTP, May, 2020*) (*5 marks*)

**Answer:**

**Computation of Basic Earnings Per Share (as per AS 20 Earnings Per Share)**

| | **Year 2018-19 ₹** | **Year 2019-20 ₹** |
|---|---|---|
| ***EPS for the year 2018-19 as originally reported*** | | |
| $= \frac{\text{Net Profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$ | | |
| = (₹30,00,000 / 20,00,000 shares) | 1.5 | |
| ***EPS for the year 2018-19 restated for rights issue*** | | |
| = [₹30,00,000 / (20,00,000 shares× 1.04 (W.N. 2)] | 1.44 (approx.) | |
| ***EPS for the year 2019-20 including effects of rights issue*** | | |
| $= \frac{\text{Rs. } 50,00,000}{(20,00,000 \textit{ shares} \times 1.04 \times 2/12) + (24,00,000 \textit{ shares} \times 10/12)}$ | | 2.13 (approx.) |
| **₹50,00,000/ 23,46,667 shares** | | |

**Working Notes:**

1. Computation of theoretical ex-rights fair value per share

$$= \frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the exercise}}$$

$$= \frac{(\text{Rs. 26 x 20,00,000 shares}) + (\text{Rs. 20 x 4,00,000 shares})}{\text{20,00,000 shares + 4,00,000 shares}}$$

$$= \frac{\text{Rs. 6,00,00,000}}{\text{24,00,000 shares}} = \text{Rs.25}$$

2. Computation of adjustment factor

$$= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}} = \frac{\textbf{\textit{Rs.26}}}{\textbf{\textit{Rs. (Refer Working Note1)}}} = 1.04 \text{(approx.)}$$

## Question 27

On 1st April, 2019 a company had 6,00,000 equity shares of ₹10 each (₹5 paid up by all shareholders). On 1st September, 2019 the remaining ₹5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net pro fit for the year ended 31st March, 2020 was ₹21,96,000 after considering dividend on preference shares and dividend distribution tax on such dividend totalling to ₹3,40,000.

You are required to compute Basic EPS for the year ended 31st March, 2020 as per Accounting Standard 20 "Earnings Per Share".

(*MTP, October, 2020*) (*5 marks*)

**Answer**

Basic Earnings per share (EPS) =

$$\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{21,96,000}{4,57,500 \text{ Shares (as per working note)}} = ₹\ 4.80 \text{ per share}$$

**Working Note:**

**Calculation of weighted average number of equity shares**

As per AS 20 ‘Earnings Per Share’, partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

| ***Date*** | ***No. of equity shares*** | ***Amount paid per share*** | ***Weighted average no. of equity shares*** |
|---|---|---|---|
| | ₹ | ₹ | ₹ |
| 1.4.2020 | 6,00,000 | 5 | 6,00,000 x 5/10 x 5/12 = 1,25,000 |
| 1.9.2020 | 5,40,000 | 10 | 5,40,000 x 7/12 = 3,15,000 |
| 1.9.2020 | 60,000 | 5 | 60,000 x 5/10 x 7/12 = 17,500 |
| Total weighted average equity shares | | | 4,57,500 |

## Question 28

A-One Limited supplied the following information. You are required to compute the basic earnings per share as per AS 20 'Earnings per Share':

Net profit attributable to equity shareholders — Year 2017-18: ₹1,00,00,000; Year 2018-19 : ₹1,50,00,000

Number of shares outstanding prior to

| | |
|---|---|
| Right Issue | 50,00,000 shares |
| Right Issue | One new share for each four outstanding shares i.e., 12,50,000 shares<br>Right Issue Price - ₹96<br>Last date of exercising rights - 30-06-2018 |
| Fair value of one equity share immediately prior to exercise of rights on 30-06-2018 | ₹101 |

(*RTP, November, 2020*)

**Answer**

**Computation of Basic earnings per share**

| | 2017-18 ₹ | 2018-19 ₹ |
|---|---|---|
| EPS for the year 2017-18 as originally reported: (₹1,00,00,000/ 50,00,000 shares) | 2.00 | |
| EPS for the year 2017-18 restated for rights issue: ₹1,00,00,000/ (50,00,000 shares x 1.01)* | 1.98 | |
| EPS for the year 2018-19 including effects of rights issue $\frac{\text{Rs.}1,50,00,000}{(50,00,000 \times 1.01 \times 3/12)+(62,50,000 \times 9/12)}$ | | 2.52 |

* *Computation of Basic Earnings per share in case of Rights Issue requires computation of adjustment factor which is given as working note.*

**Working Notes:**

1. Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the exercise}}$$

$$\frac{(₹101 \times 50,00,000 \text{ shares}) + (₹\ 96 \times 12,50,000 \text{ shares})}{50,00,000 \text{ shares} + 12,50,000 \text{ shares}}$$

= ₹62,50,00,000/62,50,000 = ₹100

Therefore, theoretical ex-rights fair value per share is = ₹100

2. Computation of adjustment factor

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}} = \frac{₹(101}{₹(100)} = 1.01$$

## Question 29

Explain the concept of 'weighted average number of equity shares outstanding during the period'. Also compute, based on AS 20, the weighted average number of equity shares in the following case:

| | | **No. of shares** |
|---|---|---|
| 1st April, 2020 | Balance of equity shares | 7,20,000 |
| 31st August, 2020 | Equity shares issued for cash | 2,40,000 |
| 1st February, 2021 | Equity shares bought back | 1,20,000 |
| 31st March, 2021 | Balance of equity shares | 8,40,000 |

(*MTP, April, 2021*) (*5 marks*)

**Answer**

As per AS 20, "Earnings Per Share", the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or less number of shares outstanding at any time. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Weighted average number of equity shares:

| | |
|---|---|
| 7,20,000 X 5/12 | = 3,00,000 shares |
| 9,60,000 X 5/12 | = 4,00,000 shares |
| 8,40,000 X 2/12 | = 1,40,000 shares |
| | = 8,40,000 shares |

## Question 30

On 1st April, 2019 a company had 6,00,000 equity shares of ₹10 each (₹5 paid up by all shareholders). On 1st September, 2019 the remaining ₹5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 2020 was ₹21,96,000 after considering dividend ₹3,40,000 on preference shares.

You are required to compute Basic EPS for the year ended 31st March, 2020 as per Accounting Standard 20 "Earnings Per Share".

(*MTP*, *October 2021*) (*5 Marks*)

**Answer**

Basic Earnings per share (EPS) =

$$\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{21,96,000}{4,57,500 \text{ Shares (as per working note)}} = ₹\ 4.80 \text{ per share}$$

**Working Note:**

**Calculation of weighted average number of equity shares**

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

| *Date* | *No. of equity shares* | *Amount paid per share* | *Weighted average no. of equity shares* | |
|---|---|---|---|---|
| | ₹ | ₹ | ₹ | |
| 1.4.2020 | 6,00,000 | 5 | 6,00,000 x 5/10 x 5/12 | = 1,25,000 |
| 1.9.2020 | 5,40,000 | 10 | 5,40,000 x 7/12 | = 3,15,000 |
| 1.9.2020 | 60,000 | 5 | 60,000 x 5/10 x 7/12 | = 17,500 |
| Total weighted average equity shares | | | | 4,57,500 |

## Question 31

AB Limited is a company engaged in manufacturing industrial packaging equipment. As per the terms of an agreement entered with its debenture holders, the company is required to appropriate adequate portion of its profits to a specific reserve over the period of maturity of the debentures such that, at the redemption date, the reserve constitutes at least half the value of such debentures. As such appropriations are not available for distribution to the equity shareholders, AB Limited has excluded this from the numerator in the computation of Basic EPS. Is this treatment correct as per provisions of AS 20?

(*RTP November 2021*)

**Answer**

The appropriation made to such a mandatory reserve created for the redemption of debentures would be included in the net profit attributable to equity shareholders for the computation of Basic EPS. AS 20 states that "For the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period". With an emphasis on the phrase attributable to equity shareholders, it may be construed that such amounts appropriated to mandatory reserves, though not available for distribution as dividend, are still attributable to equity shareholders. Accordingly, these amounts should be included in the computation of Basic EPS. In view of this, the treatment made by the company is not correct.

## Question 32

(a) Stock options have been granted by AB Limited to its employees and they vest equally over 5 years, i.e., 20 per cent at the end of each year from the date of grant. The options will vest only if the employee is still employed with the company at the end of the year. If the employee leaves the company during the vesting period, the options that have vested can be exercised, while the others would lapse. Currently, AB Limited includes only the vested options for calculating Diluted EPS. Should only completely vested options be included for computation of Diluted EPS? Is this in accordance with the provisions of AS 20? Explain.

(b) X Limited, as at March 31, 2021, has income from continuing ordinary operations of ₹2,40,000, a loss from discontinuing operations of ₹3,60,000 and accordingly a net loss of ₹1,20,000. The Company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 2021. You are required to compute Basic and Diluted EPS?

(*RTP May, 2022*)

**Answer**

**(a)** The current method of calculating Diluted EPS adopted by AB limited is not in accordance with AS 20. The calculation of Diluted EPS should include all potential equity shares, i.e., all the stock options granted at the balance sheet date, which are dilutive in nature, irrespective of the vesting pattern. The options that have lapsed during the year should be included for the portion of the period the same were outstanding, pursuant to the requirement of the standard.

AS 20 states that "A potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares". Options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans are examples of potential equity shares. Further, for the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.

**(b)** As per AS 20 "Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations". As income from continuing ordinary operations, ₹2,40,000 would be considered and not ₹(1,20,000), for ascertaining whether 200 potential equity shares are dilutive or anti-dilutive. Accordingly, 200 potential equity shares would be dilutive potential equity shares since their inclusion would decrease the net profit per share from continuing ordinary operations from ₹240 to ₹200. Thus the basic E.P.S would be ₹(120) and diluted E.P.S. would be ₹(100).

## Question 33

"At the time of calculating diluted earnings per share, effect is given to all dilutive potential equity shares that are outstanding during the period."

Comment and also calculate the basic and diluted earnings per share for the year 2020-21 from the following information:

| | | |
|---|---|---|
| (i) | Net profit after tax for the year | ₹64,12,500 |
| (ii) | No. of equity shares outstanding | ₹15,00,000 |
| (iii) | No. of 9% convertible debentures of ₹100 issued on 1st July, 2020 | 75,000 |
| (iv) | Each debenture is convertible into 8 Equity Shares | |
| (v) | Tax relating to interest expenses | 35% |

(*Question Paper of December 2021*) *(5 Marks)*

**Answer**

In calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period." As per AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding∗ during the period should be adjusted for the effects of all dilutive potential equity shares for the purpose of calculation of diluted earnings per share.

Basic EPS for the year 2020-21= 64,12,500/15,00,000 = ₹4.275 or ₹4.28

**Computation of diluted earnings per share for year 2020-21**

$$\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$$

Adjusted net profit for the current year will be (64,12,500 + 5,06,250 – 1,77,188) = ₹67,41,562

No. of equity shares resulting from conversion of debentures: 6,00,000 Shares (75,000 × 8)

Weighted average no. of equity shares used to compute diluted EPS: (15,00,000 X 12/12 + 6,00,000 X 9/12) = 19,50,000 Shares

Diluted earnings per share: (67,41,562/19,50,000) = ₹3.46

**Working Note:**

Interest expense for 9 months = 75,00,000 × 9% × 9/12 = ₹5,06,250 Tax expense 35% on interest is ₹1,77,188 (5,06,250 x 35%)

∗ Weighted average number of equity shares outstanding during the period is increased by the weighted average number of additional equity shares which would have been outstanding assuming the conversion of all dilutive potential equity shares.

## Question 34

*The following information is provided to you:*

| | |
|---|---|
| Net profit for the year 2022: | ₹ 72,00,000 |
| Weighted average number of equity shares outstanding during the year 2022: | 30,00,000 shares |
| Average Fair value of one equity share during the year 2022: | ₹ 25.00 |
| Weighted average number of shares under option during the year 2022: | 6,00,000 shares |
| Exercise price for shares under option during the year 2022: | ₹ 20.00 |

You are required to compute Basic and Diluted Earnings Per Share as per AS 20.

(*Suggested November, 2022*) (*5 Marks*)

**Answer**

**Computation of Basic earnings per share**

| | ***Earnings*** ***₹*** | ***Shares*** | ***Earnings/ Share*** ***₹*** |
|---|---|---|---|
| Net profit for the year 2022 | 72,00,000 | | |
| Weighted average no. of shares during year 2022 | | 30,00,000 | |
| Basic earnings per share (72,00,000/30,00,000) | | | 2.40 |

**Computation of Diluted earnings per share**

| | ***Earnings*** ***₹*** | ***Shares*** | ***Earnings/Share*** ***₹*** |
|---|---|---|---|
| Net profit for the year 2022 | 72,00,000 | | |
| Weighted average no. of shares during year 2022 | | 30,00,000 | |
| Number of shares under option | | 6,00,000 | |
| Number of shares that would have been issued at fair value (6,00,000 x 20.00)/25.00 | | (4,80,000) | |
| Diluted earnings per share | 72,00,000 | 31,20,000 | 2.31 (rounded-off) |

Note: The earnings have not been increased as the total number of shares has been increased only by the number of shares (1,20,000) deemed for the purpose of the computation to have been issued for no consideration.

To the extent that partly paid shares are not entitled to participate in dividends during the reporting period they are considered the equivalent of options.

## Question 35

The following information relates to XYZ Limited for the year ended 31st March, 2022: Net Profit for the year after tax: ₹ 37,50,000

Number of Equity Shares of ₹ 10 each outstanding: ₹ 5,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

| **Particulars** | **Nos.** |
|---|---|
| 8% Convertible Debentures of ₹ 100 each | 50,000 |
| Equity Shares to be issued on conversion | 55,000 |

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

(*RTP November, 2022*)

**Answer**

**Computation of basic earnings per share**

Net profit for the current year / Weighted average number of equity shares outstanding during the year ₹ 37,50,000/ 5,00,000 = ₹ 7.50 per share

**Computation of diluted earnings per share** $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

Adjusted net profit for the current year

Weighted average number of equity shares

**Adjusted net profit for the current year**

| | ₹ |
|---|---|
| Net profit for the current year | 37,50,000 |
| *Add*: Interest expense for the current year | 4,00,000 |
| *Less*: Tax relating to interest expense (30% of ₹ 4,00,000) | (1,20,000) |
| Adjusted net profit for the current year | 40,30,000 |

**Number of equity shares resulting from conversion of debentures**

= 55,000 Equity shares (given in the question)

**Weighted average number of equity shares used to compute diluted earnings per share**

= 5,55,000 shares (5,00,000 + 55,000)

**Diluted earnings per share**

= 40,30,000/ 5,55,000 = ₹ 7.26 per share

**Note:** Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

## Question 36

Following information is supplied by K Ltd.:

Number of shares outstanding prior to right issue - 2,50,000 shares.

Right issue - two new share for each 5 outstanding shares (i.e. 1,00,000 new shares)

Right issue price - ₹ 98

Last date of exercising rights - 30-06-2021.

Fair value of one equity share immediately prior to exercise of right on 30-06-2021 is ₹ 102.

Net Profit to equity shareholders:

2020-2021 - ₹ 50,00,000

2021-2022 -₹ 75,00,000

You are required to calculate the basic earnings per share as per AS-20 Earnings per Share.

(*RTP May, 2023*)

**Answer**

$$\frac{\text{Fair value of shares immediately prior to exercise of rights + Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + Number of shares issued in the exercise}}$$

$$\frac{102 \times 2{,}50{,}000 \text{ Shares} + ₹\ 98 \times 1{,}00{,}000 \text{ shares}}{3{,}50{,}000 \text{ shares}}$$

Theoretical ex-rights fair value per share = ₹ 100.86

Computation of adjustment factor:

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}} = 102/100.86 = 1.01$$

**Computation of earnings per share:**

EPS for the year 2020-21 as originally reported: ₹ 50,00,000/2,50,000 shares = ₹ 20

EPS for the year 2020-21 restated for rights issue: =₹ 50,00,000/ (2,50,000 shares x 1.01) = ₹ 19.80

EPS for the year 2021-22 including effects of rights issue:

EPS = 75,00,000/3,25,625* = ₹ 23.03

** [(2,50,000 x 1.01 x 3/12) + (3,50,000 x 9/12)] =63,125 + 2,62,500 = 3,25,625 shares*

**Note**: Financial year (ended 31st March) is considered as accounting year while giving the above answer.

CHAPTER 9

# Accounting Standard 24 Discontinuing Operations

## Question 1

*ABC Ltd. developed know-how by incurring expenditure of ₹20 lakhs, The know-how was used by the company from 1.4.20X1. The useful life of the asset is 10 years from the year of commencement of its use. The company has not amortised the asset till 31.3.20X8. Pass Journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.20X8.*

(*Source: Illustration 1, Study Material*)

**Answer**

**Journal Entry**

| | | ₹ | ₹ |
|---|---|---|---|
| Profit and Loss A/c (Prior period item) | Dr. | 12,00,000 | |
| Amortization A/c | Dr. | 2,00,000 | |
| To Know-how A/c[1] | | | 14,00,000 |
| [Being amortization of 7 years (out of which amortization of 6 years charged as prior period item)] | | | |

## Question 2

*The company had spent ₹45 lakhs for publicity and research expenses on one of its new consumer product, which was marketed in the accounting year 20X1 -20X2, but proved to be a failure. State, how you will deal with the following matters in the accounts of U Ltd. for the year ended 31st March, 20X2.*

(*Source: Illustration 2, Study Material*)

**Answer**

In the given case, the company spent ₹45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/benefit because of the failure of the product. Thus, according to AS 26 'Intangible Assets', the company should charge the total amount of ₹45 lakhs as an expense in the profit and loss account.

## Question 3

*A company with a turnover of ₹250 crores and an annual advertising budget of ₹2 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹25 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of ₹2 crore incurred on extensive special initial advertisement campaign for the new product.*

1 As per para 63 of AS 26 "Intangible Assets", there is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.

*Is the procedure adopted by the company correct?*

(*Source: Illustration 3, Study Material*)

**Answer**

According to AS 26 'Intangible Assets', "expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset".

AS 26 mentions that expenditure on advertising and promotional activities should be recognised as an expense when incurred.

In the given case, advertisement expenditure of ₹2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹25 crores. Here, no intangible asset or other asset is acquired or created that can be recognised. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹2 crores to the Profit and Loss account of the year is correct.

## Question 4

*What is meant by Intangible Assets and what are the important factors to consider the recognition of item as an Intangible asset? What is the recognition criteria in accordance with the provisions of AS 26?*

(*Source: Question 5, Study Material*)

**Answer**

An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Below are the 3 key ingredients to be satisfied to cover an item as an intangible asset under this standard:

- identifiability,
- control over a resource and
- expectation (i.e. probable – 50% plus) of future economic benefits flowing to the enterprise.

The recognition of an item as an intangible asset requires an enterprise to demonstrate that the item meets the definition of an intangible asset and recognition criteria set out as below:

a. It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and

b. The cost of the asset can be measured reliably.

## Question 5

*What is the measurement criteria at the time of initial recognition of Intangible assets acquired through separate acquisition?*

(*Source: Question 6, Study Material*)

**Answer**

If an intangible asset is acquired separately, the cost of the intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

The cost of an intangible asset comprises:

- its purchase price,
- any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), and
- any directly attributable expenditure on making the asset ready for its intended use. Directly attributable expenditure includes, for example, professional fees for legal services.
- Any trade discounts and rebates are deducted in arriving at the cost.

## Question 6

*What is the criteria for recognition and measurement of Internally generated intangible assets. Describe which kind of cost is considered for capitalisation with respect to provisions of AS 26. Whether the same applies for internally generated goodwill also?*

(*Source: Question 7, Study Material*)

**Answer**

To assess whether an internally generated intangible asset meets the criteria for recognition, an enterprise classifies the generation of the asset into 2 phases:

- Research Phase &
- Development Phase

Research Phase - The expenses related to Research phase is expensed off in statement of Profit and loss.

Development Phase - Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the conditions given in para 6.15.

**Cost of an Internally Generated Intangible Asset**

The cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria. Reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports is prohibited.

The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and making the asset ready for its intended use from the time when the intangible asset first meets the recognition criteria. For details, refer para 6.16.

Internally generated goodwill is not recognised as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

## Question 7

*Advise the complete accounting treatment for Research and development phase as per AS 26.*

(*Source: Question 8, Study Material*)

**Answer**

Research phase means acquisition of knowledge and Development phase means application of knowledge.

The expenditure related to Research phase is expensed off in statement of Profit and loss. However, the expenditure incurred in Development phase is capitalised as a cost of the internally generated intangible asset.

If an enterprise cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the enterprise treats the expenditure on that project as if it were incurred in the research phase only.

## Question 8

*What is meant by Amortisation of an Intangible asset. What are the different methods for amortisation as per AS 26?*

(*Source: Question 9, Study Material*)

**Answer**

Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

The amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used. A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include

- the straight-line method,
- the diminishing balance method and
- the unit of production method.

The method used for an asset is selected based on the expected pattern of consumption of economic benefits and is consistently applied from period to period, unless there is a change in the expected pattern of consumption of economic benefits to be derived from that asset.

## Question 9

*Swift Ltd. acquired a patent at a cost of ₹80,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset at ₹10,00,000 per annum. The company had amortized the patent at 10,00,000 per annum in first two years on the basis of economic benefits derived from the product manufactured under the patent. After two years it was found that the product life-cycle may continue for another 5 years from then. The patent was renewable and Swift Ltd. got it* *renewed after expiry of five years. The net cash flows from the product during these 5 years were expected to be ₹36,00,000, ₹46,00,000, ₹44,00,000, ₹40,00,000 and ₹34,00,000. Find out the amortization cost of the patent for each of the years.*

(*Source: Question 10, Study Material*)

**Answer**

Swift Limited amortised ₹10,00,000 per annum for the first two years i.e. ₹20,00,000. The remaining carrying cost can be amortised during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

| S | Net cash flows ₹ | Amortisation Ratio | Amortisation Amount ₹ |
|---|---|---|---|
| I | - | 0.125 | 10,00,000 |
| II | - | 0.125 | 10,00,000 |
| III | 36,00,000 | 0.180 | 10,80,000 |
| IV | 46,00,000 | 0.230 | 13,80,000 |
| V | 44,00,000 | 0.220 | 13,20,000 |
| VI | 40,00,000 | 0.200 | 12,00,000 |
| VII | 34,00,000 | 0.170 | 10,20,000 |
| Total | 2,00,00,000 | 1.000 | 80,00,000 |

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹60,00,000 has been amortised in the ratio of net cash flows arising from the product of Swift Ltd.

## Question 10

*AB Ltd. launched a project for producing product X in October, 20X1. The Company incurred ₹20 lakhs towards Research. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.*

*Advise the Company as per the applicable Accounting Standard.*

(*Source: Question 11, Study Material*)

**Answer**

As per para 41 of AS 26 "Intangible Assets", expenditure on research should be recognised as an expense when it is incurred. Hence, the expenses amounting ₹20 lakhs incurred on the research has to be charged to the statement of profit and loss in the current year ending 31st March, 20X2.

## Question 11

*During 20X1-X2, an enterprise incurred costs to develop and produce a routine low risk computer software product, as follows:*

| *Particular* | *₹* |
|---|---|
| *Completion of detailed program and design (Phase 1)* | *50,000* |
| *Coding and Testing (Phase 2)* | *40,000* |
| *Other coding costs (Phase 3 & 4)* | *63,000* |
| *Testing costs (Phase 3 & 4)* | *18,000* |
| *Product masters for training materials (Phase 5)* | *19,500* |
| *Packing the products (1,500 units) (Phase 6)* | *16,500* |

*After completion of phase 2, it was established that the product is technically feasible for the market. You are required to state how the above referred cost to be recognized in the books of accounts.*

(*Source: Question 12, Study Material*)

**Answer:**

As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed program design, coding and testing. In this case, ₹90,000 would be recorded as an expense (₹50,000 for completion of detailed program design and ₹40,000 for coding and testing to establish technological feasibility/asset recognition criteria). Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (63,000+ 18,000+ 19,500) = ₹1,00,500. Packing cost ₹16,500 should be recognized as expenses and charged to P & L A/c.

# QUESTION BANK

## Question 12

A consumer goods producer has changed the product line as follows:

| | Dish washing Bar (Per month) | Clothes washing Bar (Per month) |
|---|---|---|
| January 2016 - September 2016 | 2,00,000 | 2,00,000 |
| October 2016 - December 2016 | 1,00,000 | 3,00,000 |
| January 2017 - March 2017 | Nil | 4,00,000 |

The company has enforced a gradual enforcement of change in product line on the basis of an overall plan. The Board of Directors has passed a resolution in March 2016 to this effect. The company follows calendar year as its accounting year.

You required to advise the company whether it should be treated as discontinuing operation or not as per AS 24?

(*MTP August 2018/April 2019 & RTP May 2018*)

**Answer:**

As per AS 24 'Discontinuing Operations', a discontinuing operation is a component of an enterprise:

(i) that the enterprise, pursuant to a single plan, is:
   (1) disposing of substantially in its entirety,
   (2) disposing of piecemeal, or
   (3) terminating through abandonment; and

(ii) that represents a separate major line of business or geographical area of operations; and

(iii) that can be distinguished operationally and for financial reporting purposes.

As per provisions of the standard, business enterprises frequently close facilities, abandon products or even product lines, and change the size of their work force in response to market forces. While those kinds of terminations generally are not, in themselves, discontinuing operations, they can occur in connection with a discontinuing operation. Examples of activities that do not necessarily satisfy criterion of discontinuing operation are gradual or evolutionary phasing out of a product line or class of service, discontinuing, even if relatively abruptly, several products within an ongoing line of business;

In the given case, the company has enforced a gradual enforcement of change in product line and does not represent a separate major line of business and hence is not a discontinued operation. If it were a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

(i) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or

(ii) the enterprises board of directors or similar governing body has both approved a detailed, formal plan for discontinuance and made an announcement of the plan.

## Question 13

What are the initial disclosure requirements of AS 24 for discontinuing operations?

*(November 2018) (5 marks)*

**Answer*:***

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

A. A description of the discontinuing operation(s)

B. The business or geographical segment(s) in which it is reported as per AS 17

C. The date and nature of the initial disclosure event.

D. The date or period in which the discontinuance is expected to be completed if known or determinable

E. The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled

F. The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period

G. The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto

H. The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period

## Question 14

Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

(*RTP November 2018*)

**Answer:**

Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations. According to Paragraph 9 of AS 24, examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include:

(i) Gradual or evolutionary phasing out of a product line or class of service;

(ii) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;

(iii) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(iv) Closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

## Question 15

What do you understand by Discontinuing Operations? What are the disclosure and presentation requirements of AS 24 for discontinuing operations? Explain in brief.

(*RTP, November, 2020*)

**Answer**

As per AS 24 "Discontinuing Operations", a discontinuing operation is a component of an enterprise:

(a) That the enterprise, pursuant to a single plan, is:

  (i) Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or

  (ii) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or

  (iii) Terminating through abandonment and

(b) That represents a separate major line of business or geographical area of operations.

(c) That can be distinguished operationally and for financial reporting purposes.

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

- A description of the discontinuing operation(s);
- The business or geographical segment(s) in which it is reported as per AS 17;
- The date and nature of the initial disclosure event.
- The date or period in which the discontinuance is expected to be completed if known or determinable,
- The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
- The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;
- The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto;
- The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

## Question 16

Arzoo Ltd. is in the business of manufacture of passenger cars and commercial vehicles. The company is working on a strategic plan to shift from the passenger car segment to the commercial vehicles segment over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its plan, it has planned that it will reduce the production of passenger cars by 20% annually. It also plans to commence another new factory for the manufacture of commercial vehicles plus transfer of employees in a phased manner. These plans have not approved from the Board of Directors and the new factory for manufacture of commercial vehicles has not yet started. You are required to comment if mere gradual phasing out in itself can be considered as a 'Discontinuing Operation' within the meaning of AS 24.

**Answer**

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

(1) Gradual or evolutionary phasing out of a product line or class of service;

(2) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;

(3) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(4) Closing of a facility to achieve productivity improvements or other cost savings.

In view of the above, mere gradual phasing out in itself cannot be considered as discontinuing operation. The companies' strategic plan also has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.

## Question 17

Rohini Limited is in the business of manufacture of passenger cars and commercial vehicles. The Company is working on a strategic plan to close the production of passenger cars and to produce only commercial vehicles over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its prospective plan it will reduce the production of passenger cars by 20% annually. It also plans to establish another new factory for the manufacture of commercial vehicles and transfer surplus employees in a phased manner. You are required to comment:

(i) If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.

(ii) If the Company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24?

(iii) Would your answer to the above be different if the Company resolves to sell the assets of the passenger car division in a phased but time bound manner?

(*July, 2021 Suggested*) (*5 Marks*)

**Answer**

**(i) As per AS 24, a discontinuing operation is a component of an enterprise:**

(a) that the enterprise, pursuant to a single plan, is:

(i) disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders; or

(ii) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or

(iii) terminating through abandonment; and

(b) that represents a separate major line of business or geographical area of operations; and

(c) that can be distinguished operationally and for financial reporting purposes.

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'. Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

(a) Gradual or evolutionary phasing out of a product line or class of service;

(b) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(c) Closing of a facility to achieve productivity improvements or other cost savings. In this case, it cannot be considered as Discontinuing Operation as per AS-24 as the companies' strategic plan has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.

**(ii)** No, the resolution is salient about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer proposal were passed through a resolution to the new factory, but the closure road map and new segment starting roadmap are missing.

Hence, AS 24 will not be applicable and it cannot be considered as Discontinuing operations.

**(iii)** Yes, phased and time bound program resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap.

Hence, this action will attract compliance of AS 24 and it will be considered as Discontinuing Operations as per AS-24.

## Question 18

What are discontinuing operations as per AS 24? Should an enterprise include prescribed information relating to a discontinuing operation in its financial statements?

(*RTP November 2021*)

**Answer**

A discontinuing operation is a component of an enterprise:

(a) That the enterprise, pursuant to a single plan, is:

(i) Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or

(ii) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or

(iii) Terminating through abandonment and

(b) That represents a separate major line of business or geographical area of operations.

(c) That can be distinguished operationally and for financial reporting purposes.

An enterprise should include prescribed information relating to a discontinuing operation in its financial statements, as per requirements of AS 24, beginning with the financial statements for the period in which the initial disclosure event occurs.

## Question 19

(i) What are the disclosure and presentation requirements of AS 24 for discontinuing operations?

(ii) Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

(*RTP May, 2022*)

**Answer**

**(i)** An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

(a) a description of the discontinuing operation(s);

(b) the business or geographical segment(s) in which it is reported as per AS 17 'Segment Reporting';

(c) the date and nature of the initial disclosure event;

(d) the date or period in which the discontinuance is expected to be completed if known or determinable;

(e) the carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;

(f) the amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;

(g) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto; and

(h) the amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

**(ii)** Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations. According to AS 24, examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include:

(i) Gradual or evolutionary phasing out of a product line or class of service;

(ii) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;

(iii) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(iv) Closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

## Question 20

What are the disclosure requirement in interim financial reports as per AS 24 for discontinuing operations?

(*RTP November, 2022*)

**Answer**

**Disclosure in interim financial reports**

Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, 'Interim Financial Reporting', including:

(a) Any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation and

(b) Any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

CHAPTER 10

# Accounting Standard 25
# Interim Financial Reporting

**Question 1**

*Sincere Corporation is dealing in seasonal product. Sales pattern of the product quarter-wise is as follows:*

| | |
|---|---|
| *1st quarter 30th June* | *10%* |
| *2nd quarter 30th September* | *10%* |
| *3rd quarter 31st December* | *60%* |
| *4th quarter 31st March* | *20%* |

*Information regarding the 1st quarter ended on 30th June, 20X1 is as follows:*

| | |
|---|---|
| *Sales* | *80 crores* |
| *Salary and other expenses* | *60 crores* |
| *Advertisement expenses (routine)* | *4 crores* |
| *Administrative and selling expenses* | *8 crores* |

*While preparing interim financial report for first quarter Sincere Corporation wants to defer ₹10 crores expenditure to third quarter on the argument that third quarter is having more sales, therefore, the third quarter should be debited by more expenditure. Considering the seasonal nature of business and the expenditures are uniform throughout all quarters, calculate the result of the first quarter as per AS 25. Also give a comment on the company's view.*

**Answer**

| **Particulars** | **(₹In crores)** | |
|---|---|---|
| Result of first quarter ended 30th June, *20X1* | 80 | |
| Turnover Other Income | Nil | |
| Total (a) | | 80 |
| *Less*: Changes in inventories | | Nil |
| Salaries and other cost | | 60 |
| Administrative and selling Expenses (4+8) | | 12 |
| Total (b) | | 72 |
| Profit (a)-(b) | | 8 |

According to AS 25, the Income and Expense should be recognized when they are earned and incurred respectively. Therefore, seasonal incomes will be recognized when they occur. Thus, the company's view is not as per AS 25.

## Question 2

*The accounting year of X Ltd. ends on 30th September, 20X1 and it makes its reports quarterly. However for the purpose of tax, year ends on 31st March every year. For the Accounting year from 1-10-20X0 to 30-9-20X1, the quarterly income is as under:*

| | |
|---|---|
| *1st quarter ending on 31st December, 20X0* | *₹200 crores* |
| *2nd quarter ending on 31st March, 20X1* | *₹200 crores* |
| *3rd quarter ending on 30th June, 20X1* | *₹200 crores* |
| *4th quarter ending on 30th September, 20X1* | *₹200 crores* |
| *Total* | *₹800 crores* |

*Average actual tax rate for the financial year ending on 31st March, 20X1 is 20% and for financial year ending 31st March, 20X2 is 30%. Calculate tax expense for each quarter.*

**Answer**

**Calculation of tax expense**

| | | |
|---|---|---|
| 1st quarter ending on 31st December, 20X0 | 200 ×20% | ₹40 lakhs |
| 2nd quarter ending on 31st March, 20X1 | 200 ×20% | ₹40 lakhs |
| 3rd quarter ending on 30th June, 20X1 | 200 ×30% | ₹60 lakhs |
| 4th quarter ending on 30th September, 20X1 | 200 ×30% | ₹60 lakhs |

## Question 3

*Accountants of Poornima Ltd. showed a net profit of ₹7,20,000 for the third quarter of 20X1 after incorporating the following:*

(i) *Bad debts of ₹40,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.*

(ii) *Extra ordinary loss of ₹35,000 incurred during the quarter has been fully recognized in this quarter.*

(iii) *Additional depreciation of ₹45,000 resulting from the change in the method of charge of depreciation assuming that ₹45,000 is the charge for the 3rd quarter only.*

*Ascertain the correct quarterly income.*

**Answer**

In the above case, the quarterly income has not been correctly stated. As per AS 25 "Interim Financial Reporting", the quarterly income should be adjusted and restated as follows:

Bad debts of ₹40,000 have been incurred during current quarter. Out of this, the company has deferred 50% (i.e.) ₹20,000 to the next quarter. Therefore, ₹20,000 should be deducted from ₹7,20,000. The treatment of extra-ordinary loss of ₹35,000 being recognized in the same quarter is correct.

Recognising additional depreciation of ₹45,000 in the same quarter is in tune with AS 25. Hence no adjustments are required for these two items.

Poornima Ltd should report quarterly income as ₹7,00,000 (₹7,20,000 – ₹20,000).

## Question 4

*Intelligent Corporation (ICorp.) is dealing in seasonal products. The quarterly sales pattern of the product is given below:*

| ***Quarter I*** | ***II*** | ***III*** | ***IV*** |
|---|---|---|---|
| *Ending 30th June*<br>*15%* | *30th September*<br>*15%* | *31st December*<br>*50%* | *31st March*<br>*25%* |

*For the First quarter ending 30th June, 20X1, ICorp. gives you the following information:*

| | ***₹crores*** |
|---|---|
| *Sales* | *50* |
| *Salary and other expenses* | *30* |
| *Advertisement expenses (routine)* | *02* |
| *Administrative and selling expenses* | *08* |

*While preparing interim financial report for the first quarter, 'I–Corp.' wants to defer ₹21 crores expenditure to third quarter on the argument that third quarter is having more sales, therefore, third quarter should be debited by higher expenditure, considering the seasonal nature of business and that the expenditures are uniform throughout all quarters.*

*Calculate the result of first quarter as per AS 25 and comment on the company's view.*

**Answer**

**Result of the first quarter ended 30th June, 20X1**

| | | | (₹in crores) |
|---|---|---|---|
| Turnover | | | 50 |
| Add: Other Income | | | Nil |
| Total | | | 50 |
| Less: Change in inventories | Nil | | |
| Salaries and other cost | | 30 | |
| Administrative and selling expenses (8 + 2) | | 10 | 40 |
| Profit | | | 10 |

As per AS 25 on Interim Financial Reporting, the income and expense should be recognized when they are earned and incurred respectively. As per AS 25, the costs should be anticipated or deferred only when

(i) it is appropriate to anticipate that type of cost at the end of the financial year, and

(ii) costs are incurred unevenly during the financial year of an enterprise.

Therefore, the argument given by I-Corp relating to deferment of ₹21 crores is not tenable as expenditures are uniform throughout all quarters.

## Question 5

*What are the periods for which Interim financial Statements are required to be presented? You are required to answer your question in light of preparation of financial statements for the period ended and as at 31st December, 20X1. The Financial Year is FY 20X1-X2.*

(*Source: Question 5, Study Material*)

**Answer**

As per Accounting Standard 25, Interim reports should include interim financial statements (condensed or complete) for periods as given below.

| ***Statement*** | ***Current period*** | ***Comparative period*** |
|---|---|---|
| Balance sheet | End of current interim period | End of immediately preceding financial year |
| Statement of profit and loss | Current interim period and cumulatively for the year-to-date | Comparable interim period and year-to-date of immediately preceding financial year |
| Cash flow statement | Cumulatively for the current financial year-to-date | Comparable year-to-date of immediately preceding financial year |

In light of the above, following periods needs to be covered in interim financial statements for the period ended and as at 31st December, *20X1:*

| | |
|---|---|
| **Balance Sheet** | as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year (As at 31 December 20X1 and 31 March 20X1). |
| **Statements of Profit and Loss** | for the current interim period and cumulatively for the current financial year to date, with comparative statements of profit and loss for the comparable interim periods (current and year-to-date) of the immediately preceding financial year. (for 3 months and 9 months i.e., year to date ended 31 December 20X1 and same for 31 December 20X0 being comparative period). |

| | |
|---|---|
| **Cash Flow Statement** | cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year. (year to date i.e., 1 April 20X1 to 31 December 20X1 and 1 April 20X0 to 31 December 20X0). |

## Question 6

*Whether quarterly financial results presented under Clause 41 of the Listing Agreement entered into between Stock Exchanges and the listed enterprises meet the definition of 'interim financial report' as per AS 25 and the provisions of AS 25 should be applied on the same?*

(*Source: Question 6, Study Material*)

**Answer**

The presentation and disclosure requirements contained in AS 25 should be applied only if an enterprise prepares and presents an 'interim financial report' as defined in AS 25. Accordingly, presentation and disclosure requirements contained in AS 25 are not required to be applied in respect of interim financial results (which do not meet the definition of 'interim financial report' as per AS 25) presented by an enterprise.

The quarterly financial results presented under Clause 41 of the Listing Agreement do not meet the definition of 'interim financial report' as per AS 25. However, the recognition and measurement principles laid down in AS 25 should be applied for recognition and measurement of items contained in such interim financial results.

## Question 7

*Whether the impairment loss recognized on property, plant and equipment in first quarter of the financial year can be reversed in the second quarter in that financial year?*

(*Source: Question 7, Study Material*)

**Answer**

As per AS 25, the principles for recognising and measuring losses from inventory write-downs, restructurings, or impairments in an interim period are the same as those that an enterprise would follow if it prepared only annual financial statements. However, if such items are recognised and measured in one interim period and the estimate changes in a subsequent interim period of that financial year, the original estimate is changed in the subsequent interim period either by accrual of an additional amount of loss or by reversal of the previously recognised amount. In light of the same, the impairment loss recognized in one quarter can be reversed in the another quarter of the financial year, if favourable indicator exists as per AS 28 and the recoverable amount increased in comparison to earlier period.

## Question 8

*In view of the provisions of Accounting Standard 25 on Interim Financial Reporting, on what basis will you calculate, for an interim period, the provision in respect of defined benefit schemes like pension, gratuity etc. for the employees?*

(*Source: Question 8, Study Material*)

**Answer**

Accounting Standard 25 suggests that provision in respect of defined benefit schemes like pension and gratuity for an interim period should be calculated based on the year-to-date basis by using the actuarially determined rates at the end of the prior financial year, adjusted for significant market fluctuations since that time and for significant curtailments, settlements or other significant one-time events.

## Question 9

*On 30th June, 20X1, Asmitha Ltd. incurred ₹2,00,000, net loss from disposal of a business segment. Also, on 31st July, 20X1, the company paid ₹60,000 for property taxes assessed for the calendar year 20X1. How the above transactions should be included in determination of net income of Asmitha Ltd. for the six months interim period ended on 30th September, 20X1.*

(*Source: Question 9, Study Material*)

**Answer**

According to Para 10 of AS 25 “Interim Financial Reporting”, if an enterprise prepares and presents a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial statements. As at 30th September, 20X1, Asmitha Ltd would report the entire amount of ₹2,00,000 as loss on the disposal of its business segment since the loss was incurred during interim period. A cost charged as an expense in an annual period should be allocated to interim periods on accrual basis.

Since ₹60,000 Property tax payment relates to entire calendar year 20X1,

₹30,000 would be reported as an expense for six months ended on 30th September, 20X1 while out of the remaining ₹30,000, ₹15,000 for January, 20X1 to March, 20X1 should be shown as payment of the outstanding amount of previous year and another ₹15,000 related to quarter October, 20X1 to December, 20X1 would be reported as prepaid expenses.

## Question 10

*An enterprise reports quarterly, estimates an annual income of ₹10 lakhs. Assume tax rates on 1st ₹5,00,000 at 30% and on the balance income at 40%. The estimated quarterly income are ₹75,000, ₹2,50,000, ₹3,75,000 and ₹3,00,000.*

*Calculate the tax expense to be recognized in each quarter.*

(*Source: Question 10, Study Material*)

**Answer**

As per para 29 of AS 25 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

| | | ₹ |
|---|---|---|
| Estimated Annual Income | (A) | 10,00,000 |
| Tax expense: | | |
| 30% on ₹5,00,000 | | 1,50,000 |
| 40% on remaining ₹5,00,000 | | 2,00,000 |
| | (B) | 3,50,000 |

Weighted average annual income tax rate =

$$\frac{B}{A} = \frac{3,50,000}{10,00,000} = 35\%$$

A 10,00,000

| *Tax expense to be recognized in each of the quarterly reports* | | ₹ |
|---|---|---|
| Quarter I - | ₹ 75,000 x 35% | 26,250 |
| Quarter II - | ₹2,50,000 x 35% | 87,500 |
| Quarter III - | ₹3,75,000 x 35% | 1,31,250 |
| Quarter IV - | ₹3,00,000 x 35% | 1,05,000 |
| | ₹10,00,000 | 3,50,000 |

## Question 11

*Antarbarti Limited reported a Profit Before Tax (PBT) of ₹4 lakhs for the third quarter ending 30-09-20X1. On enquiry you observe the following. Give the treatment required under AS 25:*

*(i) Dividend income of ₹4 lakhs received during the quarter has been recognized to the extent of ₹1 lakh only.*

*(ii) 80% of sales promotion expenses ₹15 lakhs incurred in the third quarter has been deferred to the fourth quarter as the sales in the last quarter is high.*

*(iii) In the third quarter, the company changed depreciation method from WDV to SLM, which resulted in excess depreciation of ₹12 lakhs. The entire amount has been debited in the third quarter, though the share of the third quarter is only ₹3 lakhs.*

*(iv) ₹2 lakhs extra-ordinary gain received in third quarter was allocated equally to the third and fourth quarter.*

*(v) Cumulative loss resulting from change in method of inventory valuation was recognized in the third quarter of ₹3 lakhs. Out of this loss ₹1 lakh relates to previous quarters.*

*(vi) Sale of investment in the first quarter resulted in a gain of ₹20 lakhs. The company had apportioned this equally to the four quarters.*

*Prepare the adjusted profit before tax for the third quarter.*

(*Source: Question 11, Study Material*)

**Answer**

As per para 36 of AS 25 "Interim Financial Reporting", seasonal or occasional revenue and cost within a financial year should not be deferred as of interim date until it is appropriate to defer at the end of the enterprise's financial year. Therefore, dividend income, extra-ordinary gain, and gain on sale of investment received during 3rd quarter should be recognised in the 3rd quarter only. Similarly, sales promotion expenses incurred in the 3rd quarter should also be charged in the 3rd quarter only.

Further, as per AS 10, Property, Plant and Equipment, if there is change in the depreciation method, such a change should be accounted for as a change in accounting estimate in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, and applied prospectively. Therefore, no adjustment would be required due to change in the method of depreciation.

Accordingly, the adjusted profit before tax for the 3rd quarter will be as follows:

**Statement showing Adjusted Profit Before Tax for the third quarter**

| | **( ₹in lakhs)** |
|---|---|
| Profit before tax (as reported) | 4 |
| Add: Dividend income ₹(4-1) lakhs | 3 |
| Excess depreciation charged in the 3rd quarter, due to change in the method | - |
| Extra ordinary gain ₹(2-1) lakhs | 1 |
| Cumulative loss due to change in the | |
| method of inventory valuation should be | 1 |
| applied retrospectively ₹(3-2) lakhs | 9 |
| | (12) |
| Less: Sales promotion expenses (80% of ₹15 lakhs) | (5) |
| Gain on sale of investment (occasional gain should not be deferred) | |
| Adjusted Profit before tax for the third quarter | (8) |

CHAPTER 11

# Accounting Standard 13 Accounting for Investments

## Question 1

*An unquoted long term investment is carried in the books at a cost of ₹2 lakhs. The published accounts of the unlisted company received in May, 20X1 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than ₹20,000. How will you deal with this in preparing the financial statements of R Ltd. for the year ended 31st March, 20X1?*

(*Source: Illustration 1, Study Material*)

***Answer***

Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution should be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. AS 13 (Revised) 'Accounting for Investments' states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. On the above basis, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to ₹20,000 in the financial statements for the year ended 31st March, 20X1.

## Question 2

*X Ltd. on 1-1-20X1 had made an investment of ₹600 lakhs in the equity shares of Y Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realisable value of all such investment on 31 -3-20X1 became ₹200 lakhs as Y Ltd. lost a case of copyright. From the given market conditions, it is apparent that the reduction in the value is not temporary in nature. How will you recognise the reduction in financial statements for the year ended on 31 -3-20X1?*

(*Source: Illustration 2, Study Material*)

***Answer***

X Ltd. invested ₹600 lakhs in the equity shares of Y Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. ₹300 lakhs and remaining as temporary (current) investment i.e. ₹300 lakhs. Irrespective of the fact that investment has been held by X Ltd. only for 3 months (from 1.1.20X1 to 31.3.20X1), AS 13 (Revised) lays emphasis on intention of the investor to classify the investment as current or long term even though the long term investment may be readily marketable.

In the given situation, the realisable value of all such investments on 31.3.20X1 became ₹200 lakhs i.e. ₹100 lakhs in respect of current investment and ₹100 lakhs in respect of long term investment.

As per AS 13 (Revised), 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value.

Accordingly, the carrying value of investment held as temporary investment should be shown at realisable value i.e. at ₹100 lakhs. The reduction of ₹200 lakhs in the carrying value of current investment will be charged to the profit and loss account.

The Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long term investment, the carrying amount is reduced to recognise the decline.

Here, Y Ltd. lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quiet a substantial figure. Losing the case of copyright may affect the business and the performance of the company in the long run. Accordingly, it will be appropriate to reduce the carrying amount of long term investment by ₹200 lakhs and show the investments at ₹100 lakhs, since the downfall in the value of shares is other than temporary. The reduction of ₹200 lakhs in the carrying value of long term investment will also be charged to the Statement of profit and loss.

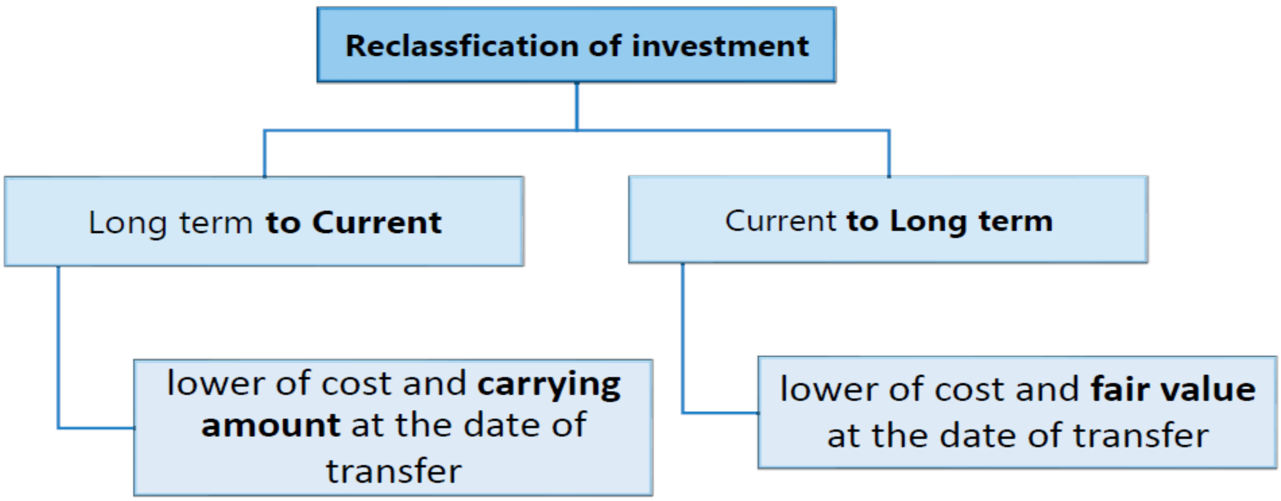
## Question 3

*ABC Ltd. wants to re-classify its investments in accordance with AS 13 (Revised). Decide and state on the amount of transfer, based on the following information:*

*(1) A portion of current investments purchased for ₹20 lakhs, to be reclassified as long term investment, as the company has decided to retain them. The market value as on the date of Balance Sheet was ₹25 lakhs.*

*(2) Another portion of current investments purchased for ₹15 lakhs, to be reclassified as long term investments. The market value of these investments as on the date of balance sheet was ₹6.5 lakhs.*

*(3) Certain long term investments no longer considered for holding purposes, to be reclassified as current investments. The original cost of these was ₹18 lakhs but had been written down to ₹12 lakhs to recognise other than temporary decline as per AS 13 (Revised).*




(*Source: Illustration 3, Study Material*)

**Answer**

As per AS 13 (Revised), where investments are reclassified from current to long- term, transfers are made at the lower of cost and fair value at the date of transfer.

(1) In the first case, the market value of the investment is ₹25 lakhs, which is higher than its cost i.e. ₹20 lakhs. Therefore, the transfer to long term investments should be carried at cost i.e. ₹20 lakhs.

(2) In the second case, the market value of the investment is ₹6.5 lakhs, which is lower than its cost i.e. ₹15 lakhs. Therefore, the transfer to long term investments should be carried in the books at the market value i.e. ₹6.5 lakhs. The loss of ₹8.5 lakhs should be charged to profit and loss account.

As per AS 13 (Revised), where long-term investments are re-classified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

(3) In the third case, the book value of the investment is ₹12 lakhs, which is lower than its cost i.e. ₹18 lakhs. Here, the transfer should be at carrying amount and hence this re-classified current investment should be carried at ₹12 lakhs.

## Question 4

*M/s Innovative Garments Manufacturing Company Limited invested in the shares of another company on 1st October, 20X3 at a cost of ₹2,50,000. It also earlier purchased Gold of ₹4,00,000 and Silver of ₹2,00,000 on 1st March, 20X1. Market value as on 31st March, 20X4 of above investments are as follows:*

| | ₹ |
|---|---|
| *Shares* | *2,25,000* |
| *Gold* | *6,00,000* |
| *Silver* | *3,50,000* |

*How above investments will be shown in the books of accounts of M/s Innovative Garments Manufacturing Company Limited for the year ending 31st March, 20 X4 as per the provisions of Accounting Standard 13 "Accounting for Investments"?*

(*Source: Illustration 4, Study Material*)

**Answer**

As per AS 13 (Revised) 'Accounting for Investments', for investment in shares if the investment is purchased with an intention to hold for short-term period (less than one year), then it will be classified as current investment and to be carried at lower of cost and fair value, i.e., in case of shares, at lower of cost (₹2,50,000) and market value (₹2,25,000) as on 31 March 20X4, i.e., ₹2,25,000.

If equity shares are acquired with an intention to hold for long term period (more than one year), then should be considered as long-term investment to be shown at cost in the Balance Sheet of the company. However, provision for diminution should be made to recognise a decline, if other than temporary, in the value of the investments.

Gold and silver are generally purchased with an intention to hold it for long term period (more than one year) until and unless given otherwise. Hence, the investment in Gold and Silver (purchased on 1st March, 20X1) should continue to be shown at cost (since there is no 'other than temporary' diminution) as on 31st March, 20X4, i.e., ₹4,00,000 and ₹2,00,000 respectively, though their market values have been increased.

## Question 5

*In 20X1, M/s. Wye Ltd. issued 12% fully paid debentures of ₹100 each, interest being payable half yearly on 30th September and 31st March of every accounting year.*

*On 1st December, 20X2, M/s. Bull & Bear purchased 10,000 of these debentures at ₹101 ex-interest price, also paying brokerage @ 1% of ex-interest amount of the purchase. On 1st March, 20X3 the firm sold all these debentures at ₹103 ex-interest price, again paying brokerage @ 1% of ex-interest amount. Prepare Investment Account in the books of M/s. Bull & Bear for the period 1st December, 20X2 to 1st March, 20X3.*

(*Source: Illustration 5, Study Material*)

**Answer**

**In the books of M/s Bull & Bear**
**Investment Account**
**for the period from 1st December 20X2 to 1st March, 20X3**
**(Scrip: 12% Debentures of M/s. Wye Ltd.)**

| Date | | Particulars | Nominal Value (₹) | Interest | Cost (₹) | Date | | Particulars | Nominal Value (₹) | Interest | Cost (₹) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1.12.20X2 | To | Bank A/c (W.N.1) | 10,00,000 | 20,000 | 10,20,100 | 1.03.20X3 | By | Bank A/c (W.N.2) | 10,00,000 | 50,000 | 10,19,700 |
| 1.3.20X3 | To | Profit & loss A/c* (b.f.) | - | 30,000 | | 1.3.20X3 | By | Profit & loss A/c (b.f.) | | | 400 |
| | | | 10,00,000 | 50,000 | 10,20,100 | | | | 10,00,000 | 50,000 | 10,20,100 |

** This represents income for M/s. Bull & Bear for the period 1st December, 20X2 to 1st March, 20X3, i.e., interest for three months- 1st December, 20X2 to 28 February, 20X3).*

**Working Notes:**

| | | | |
|---|---|---|---|
| 1. | Cost of 12% debentures purchased on 1.12.20X2 | | ₹ |
| | Cost Value (10,000 × ₹101) | = | 10,10,000 |
| | *Add*: Brokerage (1% of ₹10,10,000) | = | 10,100 |
| | Total | = | 10,20,100 |
| 2. | Sale proceeds of 12% debentures sold | | ₹ |
| | Sales Price (10,000 × ₹103) | = | 10,30,000 |
| | *Less*: Brokerage (1% of ₹10,30,000) | = | (10,300) |
| | Total | = | 10,19,700 |

## Question 6

*On 1.4.20X1, Mr. Krishna Murty purchased 1,000 equity shares of ₹100 each in TELCO Ltd. @ ₹120 each from a Broker, who charged 2% brokerage. He incurred 50 paise per ₹100 as cost of shares transfer stamps. On 31.1.20X2, Bonus was declared in the ratio of 1: 2. Before and after the record date of bonus shares, the shares were quoted at ₹175 per share and ₹90 per share respectively. On 31.3.20X2, Mr. Krishna Murty sold bonus shares to a Broker, who charged 2% brokerage.*

*Show the Investment Account in the books of Mr. Krishna Murty, who held the shares as Current assets and closing value of investments shall be made at Cost or Market value whichever is lower.*

(*Source: Illustration 6, Study Material*)

**Answer**

**In the books of Mr. Krishna Murty**
**Investment Account for the year ended 31st March, 20X2**
**(Scrip: Equity Shares of TELCO Ltd.)**

| *Date* | *Particulars* | *Nominal Value (₹)* | *Cost (₹)* | *Date* | *Particulars* | *Nominal Value (₹)* | *Cost (₹)* |
|---|---|---|---|---|---|---|---|
| 1.4.20X1 | To Bank A/c (W.N.1) | 1,00,000 | 1,23,000 | 31.3.20X2 | By Bank A/c (W.N.2) | 50,000 | 44,100 |
| 31.1.20X2 | To Bonus shares (W.N.5) | 50,000 | — | 31.3.20X2 | By Balance c/d (W.N.4) | 1,00,000 | 82,000 |
| 31.3.20X2 | To Profit & loss A/c (W.N.3) | — | 3,100 | | | | |
| | | 1,50,000 | 1,26,100 | | | 1,50,000 | 1,26,100 |

**Working Notes:**

1. Cost of equity shares purchased on 1.4.20X1 = (1,000 × ₹120) + (2% of ₹1,20,000) + (½% of ₹1,20,000) = ₹1,23,000
2. Sale proceeds of equity shares (bonus) sold on 31st March, 20X2= (500 × ₹90) – (2% of ₹45,000) = ₹44,100.
3. Profit on sale of bonus shares on 31st March, 20X2
   = Sale proceeds – Average Cost
   Sale proceeds = ₹44,100
   Average cost = ₹(1,23,000 /1,50,000) x 50,000 = ₹41,000
   Profit = ₹44,100 – ₹41,000 = ₹3,100.
4. Valuation of equity shares on 31st March, 20X2
   Cost = (₹1,23,000/1,50,000) x 1,00,000 = ₹82,000
   Market Value = 1,000 shares × ₹90 = ₹90,000
   Closing balance has been valued at ₹82,000 being lower than the market value.
5. Bonus shares do not have any cost.

## Question 7

*Mr. X purchased 500 equity shares of ₹100 each in Omega Co. Ltd. for ₹62,500 inclusive of brokerage and stamp duty. Some years later the company resolved to capitalise its profits and to issue to the holders of equity shares, one equity bonus share for every share held by them. Prior to capitalisation, the shares of Omega Co. Ltd. were quoted at ₹175 per share. After the capitalisation, the shares were quoted at ₹92.50 per share. Mr. X. sold the bonus shares and received at ₹90 per share.*

*Prepare the Investment Account in X's books on average cost basis.*

(*Source: Illustration 7, Study Material*)

**Answer**

**In the books of X Investment Account**
**[Scrip: Equity shares in Omega Co. Ltd.]**

| **Particulars** | **Nominal Value ₹** | **Cost ₹** | **Particulars** | **Nominal Value ₹** | **Cost ₹** |
|---|---|---|---|---|---|
| To Cash | 50,000 | 62,500 | By Cash - Sale (500 x 90) | 50,000 | 45,000 |
| To Bonus shares (W.N.1) | 50,000 | - | By Balance c/d (W.N. 3) | 50,000 | 31,250 |
| To P & L A/c (W.N. 2) | - | 13,750 | | | |
| | 1,00,000 | 76,250 | | 1,00,000 | 76,250 |
| To Balance b/d | 50,000 | 31,250 | | | |

**Working Notes:**

1. Bonus shares do not have any cost.
2. Profit on sale of bonus shares = Sales proceeds – Average cost

   Sales proceeds = ₹45,000

   Average cost = $\frac{500}{1000} \times 62{,}500$ = ₹31,250

   Profit = ₹45,000 – ₹31,250 = ₹13,750.
3. Valuation of Closing Balance of Shares at the end of year

   The total cost of 1,000 share including bonus is ₹62,500

   Therefore, cost of 500 shares

   (carried forward) is = $\frac{500}{1000} \times 62{,}500$ = ₹31,250

   Market price of 500 shares = 92.50 x 500 = ₹46,250

   Cost being lower than the market price, therefore shares are carried forward at cost.

## Question 8

*On 1st April, 20X1, Rajat has 50,000 equity shares of P Ltd. at a book value of ₹15 per share (nominal value ₹10 each). He provides you the further information:*

*(1) On 20th June, 20X1 he purchased another 10,000 shares of P Ltd. at ₹16 per share.*

*(2) On 1st August, 20X1, P Ltd. issued one equity bonus share for every six shares held by the shareholders.*

*(3) On 31st October, 20X1, the directors of P Ltd. announced a right issue which entitles the holders to subscribe three shares for every seven shares at ₹15 per share. Shareholders can transfer their rights in full or in part.*

*Rajat sold 1/3rd of entitlement to Umang for a consideration of ₹2 per share and subscribed the rest on 5th November, 20X1.*

*You are required to prepare Investment A/c in the books of Rajat for the year ending 31st March, 20X2.*

(*Source: Illustration 8, Study Material*)

**Answer**

**In the books of Rajat**
**Investment Account**
**(Equity shares in P Ltd.)**

| Date | Particulars | No. of shares | Amount (₹) | Date | Particulars | No. of shares | Amount (₹) |
|---|---|---|---|---|---|---|---|
| 1.4.X1 | To Balance b/d | 50,000 | 7,50,000 | 31.3.X2 | By Balance c/d (Bal. fig.) | 90,000 | 12,10,000 |
| 20.6.X1 | To Bank A/c | 10,000 | 1,60,000 | | | | |
| 1.8.X1 | To Bonus issue (W.N.1) | 10,000 | - | | | | |
| 5.11.X1 | To Bank A/c (right shares) (W.N.4) | 20,000 | 3,00,000 | | | | |
| | | 90,000 | 12,10,000 | | | 90,000 | 12,10,000 |

**Working Notes:**

(1) Bonus shares = $\frac{50{,}000 + 10{,}000}{6}$ = 10,000 shares

(2) Right shares = $\frac{50{,}000 + 10{,}000 + 10{,}000}{7} \times 3$ = 30,000 shares

(3) Sale of rights = 30,000 shares × $\frac{1}{3}$ × ₹2 = ₹20,000 to be credited to statement of profit and loss

(4) Rights subscribed = 30,000 shares × $\frac{2}{3}$ × ₹15 × ₹ 30,000

## Question 9

*On 1.4.20X1, Sundar had 25,000 equity shares of 'X' Ltd. at a book value of ₹15 per share (Nominal value ₹10). On 20.6.20X1, he purchased another 5,000 shares of the company at ₹16 per share. The directors of X Ltd. announced a bonus and rights issue. No dividend was payable on these issues. The terms of the issue are as follows:*

*Bonus basis 1:6 (Date 16.8.20X1).*

*Rights basis 3:7 (Date 31.8.20X1) Price ₹15 per share. Due date for payment 30.9.20X1.*

*Shareholders were entitled to transfer their rights in full or in part. Accordingly, Sundar sold 33.33% of his entitlement to Sekhar for a consideration of ₹2 per share.*

*Dividends: Dividends for the year ended 31.3.20X1 at the rate of 20% were declared by X Ltd. and received by Sundar on 31.10.20X1. Dividends for shares acquired by him on 20.6.20X1 are to be adjusted against the cost of purchase.*

*On 15.11.20X1, Sundar sold 25,000 equity shares at a premium of ₹5 per share. You are required to prepare in the books of Sundar.*

*(1) Investment Account*

*(2) Profit & Loss Account.*

*For your exercise, assume that the books are closed on 31.12.20X1 and shares are valued at average cost.*

(*Source: Illustration 9, Study Material*)

**Answer**

**Books of Sundar Investment Account**
**(Scrip: Equity Shares in X Ltd.)**

| | | No. | Amount ₹ | | | No. | Amount ₹ |
|---|---|---|---|---|---|---|---|
| 1.4.20X1 | To Bal b/d | 25,000 | 3,75,000 | 31.10.20X1 | By Bank (dividend On shares acquired on 20/6/20X1) (W.N.4) | — | 10,000 |
| 20.6.20X1 | To Bank | 5,000 | 80,000 | | | | |
| 16.8.20X1 | To Bonus (W.N.1) | 5,000 | — | | | | |
| 30.9.20X1 | To Bank (Rights Shares) (W.N.3) | 10,000 | 1,50,000 | | | | |
| 15.11.20X1 | To Profit (on sale of shares) | | 44,444 | 15.11.20X1 | By Bank (Sale of shares) | 25,000 | 3,75,000 |
| | | | | 31.12.20X1 | By Bal. c/d (W.N.6) | 20,000 | 2,64,444 |
| | | 45,000 | 6,49,444 | | | 45,000 | 6,49,444 |

**Profit and Loss Account (An extract)**

| | | | |
|---|---|---|---|
| To Balance c/d | 1,04,444 | By Profit transferred | 44,444 |
| | | By Sale of rights (W.N.3) | 10,000 |
| | | By Dividend (W.N.4) | 50,000 |
| | 1,04,444 | | 1,04,444 |

**Working Notes:**

(1) **Bonus shares =** $\frac{(25,000 + 5,000)}{6} = 5,000$ shares

(2) **Right shares =** $\frac{25,000 + 5,000 + 5,000}{7} \times 3 = 15,000$ shares

**(3) Right shares renounced** = 15,000×1/3 = 5,000 shares

Sale of right shares = 5,000 x 2 = ₹10,000

Right shares subscribed = 15,000 – 5,000 = 10,000 shares

Amount paid for subscription of right shares = 10,000 x 15 = ₹1,50,000

**(4) Dividend received** = 25,000 (shares as on 1st April 20X1) × 10 × 20% = ₹50,000

Dividend on shares purchased on 20.6.20X1 = 5,000×10×20% = ₹10,000 is adjusted to Investment A/c

**(5) Profit on sale of 25,000 shares**

= Sales proceeds – Average cost

Sales proceeds = ₹3,75,000

Average cost $= \left(\frac{(3,75,000 + 80,000 + 1,50,000 - 10,000)}{45,000}\right) \times 25,000 =$ ₹3,30,556

Profit = ₹3,75,000– ₹3,30,556= ₹44,444.

**(6) Cost of shares on 31.12.20X1**

$$\left(\frac{(3,75,000 + 80,000 + 1,50,000 - 10,000)}{45,000}\right) \times 20,000 = ₹2,64,444$$

| |
|---|
| **Reference:** The students are also advised to refer the full bare text of AS 13 (Revised) "Accounting for Investments". |

## Question 10

*Briefly explain disclosure requirements for Investments as per AS-13.*

(*Source: Question 6, Study Material*)

**Answer**

The disclosure requirements as per AS 13 (Revised) are as follows:

(i) Accounting policies followed for the determination of carrying amount of investments.

(ii) Classification of investment into current and long term.

(iii) The amount included in profit and loss statements for

(a) Interest, dividends and rentals for long term and current investments, disclosing therein gross income and tax deducted at source thereon;

(b) Profits and losses on disposal of current investment and changes in carrying amount of such investments;

(c) Profits and losses and disposal of long term investments and changes in carrying amount of investments.

(iv) Aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments;

(v) Any significant restrictions on investments like minimum holding period for sale/disposal, utilisation of sale proceeds or non-remittance of sale proceeds of investment held outside India.

(vi) Other disclosures required by the relevant statute governing the enterprises

## Question 11

*How will you classify the investments as per AS 13? Explain in Brief.*

(*Source: Question 7, Study Material*)

**Answer**

The investments are classified into two categories as per AS 13, viz., Current Investments and Long-term Investments.

A current Investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost and fair value. Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss.

A long-term investment is an investment other than a current investment. Long term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognise the decline. The reduction in carrying amount is charged to the statement of profit and loss.

## Question 12

*Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without providing for any diminution in value is correct and in accordance with the provisions of AS 13. If not, what should have been the accounting treatment in such a situation? Explain in brief.*

(*Source: Question 8, Study Material*)

**Answer**

The accounting treatment 'at cost' under the head 'Long Term Investment' in the financial statements of the company without providing for any diminution in value is correct and is in accordance with the provisions of AS 13 provided that there is no decline, other than temporary, in the value of investment. If the decline in the value of investment is, other than temporary, compared to the time when the shares were purchased, provision is required to be made.

## Question 13

*Mr. X acquires 200 shares of a company on cum-right basis for ₹70,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at ₹107 each. He does not subscribe but sells all the rights for ₹12,000. The market value of the shares after their becoming ex- rights has also gone down to ₹60,000. What should be the accounting treatment in this case?*

(*Source: Question 9, Study Material*)

**Answer**

As per AS 13, where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value. In this case, the amount of the ex-right market value of 200 shares bought by X immediately after the declaration of rights falls to ₹60,000. In this case, out of sale proceeds of ₹12,000, ₹10,000 may be applied to reduce the carrying amount to bring it to the market value and ₹2,000 would be credited to the profit and loss account.

## Question 14

*On 1st April, 20X1, XY Ltd. has 15,000 equity shares of ABC Ltd. at a book value of ₹15 per share (nominal value ₹10 per share). On 1st June, 20X1, XY Ltd. acquired 5,000 equity shares of ABC Ltd. for ₹1,00,000. ABC Ltd. announced a bonus and right issue.*

*(1) Bonus was declared, at the rate of one equity share for every five shares held, on 1st July 20X1.*

*(2) Right shares are to be issued to the existing shareholders on 1st September 20X1. The company will issue one right share for every 6 shares at 20% premium. No dividend was payable on these shares.*

*(3) Dividend for the year ended 31.3.20X1 were declared by ABC Ltd. @ 20%, which was received by XY Ltd. on 31st October 20X1.*

*XY Ltd.*

*(i) Took up half the right issue.*

*(ii) Sold the remaining rights for ₹8 per share.*

*(iii) Sold half of its shareholdings on 1st January 20X2 at ₹16.50 per share. Brokerage being 1%.*

*You are required to prepare Investment account of XY Ltd. for the year ended 31st March 20X2 assuming the shares are being valued at average cost.*

(*Source: Question 10, Study Material*)

**Answer**

**In the books of XY Ltd.**

**Investment in equity shares of ABC Ltd. for the year ended 31st March, 20X2**

| Date | Particulars | No. | Dividend ₹ | Amount ₹ | Date | Particulars | No. | Dividend | Amount |
|---|---|---|---|---|---|---|---|---|---|
| 20X1 April 1 | To Balance b/d | 15,000 | - | 2,25,000 | 20X1 Oct. 31 | By Bank A/c (W.N. 5) | - | 30,000 | 10,000 |
| June 1 | To Bank A/c | 5,000 | -- | 1,00,000 | 20X2 Jan. 1 | By Bank A/c (W.N.4) | 13,000 | - | 2,12,355 |
| July 1 | To Bonus Issue (W.N. 1) | 4,000 | - | - | March 31 | By Balance c/d (W.N. 6) | 13,000 | - | 1,69,500 |
| Sept.1 | To Bank A/c (W.N. 2) | 2,000 | - | 24,000 | | | | | |
| 20X2 Jan 1 | To P & L A/c (W.N. 4) | - | - | 42,855 | | | | | |
| "20X2 March 31 | To P & L A/c | - | 30,000 | - | | | | | |
| | | 26,000 | 30,000 | 3,91,855 | | | 26,000 | 30,000 | 3,91,855 |

**Working Notes:**

1. **Calculation of no. of bonus shares issued**

$$\text{Bonus Shares} = \frac{15{,}000 \text{ shares} + 5{,}000 \text{ shares}}{5} \times 1 = 4{,}000 \text{ shares}$$

2. **Calculation of right shares subscribed**

$$\text{Right Shares} = \frac{15{,}000 \text{ shares} + 5{,}000 \text{ shares} + 4{,}000 \text{ shares}}{6} = 4{,}000 \text{ shares}$$

$$\text{Shares subscribed by XY Ltd.} = \frac{4{,}000}{2} = 2{,}000 \text{ shares}$$

Value of right shares subscribed = 2,000 shares @ ₹12 per share
= ₹24,000

3. **Calculation of sale of right entitlement**

2,000 shares x ₹8 per share = ₹16,000

Amount received from sale of rights will be credited to statement of profit and loss.

4. **Calculation of profit on sale of shares**

Total holding = 15,000 shares original
5,000 shares purchased
4,000 shares bonus
2,000 shares right shares
26,000 shares

50% of the holdings were sold

i.e. 13,000 shares (26,000 x1/2) were sold.

Cost of total holdings of 26,000 shares (on average basis)

= ₹2,25,000 + ₹1,00,000 + ₹24,000– ₹10,000 = ₹3,39,000

Average cost of 13,000 shares would be

$$= \frac{3{,}39{,}000}{26{,}000} \times 13{,}000 = ₹1{,}69{,}500$$

| | |
|---|---|
| Sale proceeds of 13,000 shares (13,000 x ₹16.50) | 2,14,500 |
| *Less*: 1% Brokerage | (2,145) |
| | 2,12,355 |
| *Less:* Cost of 13,000 shares | (1,69,500) |
| Profit on sale | 42,855 |

**5. Dividend received on investment held as on 1st April, 20X1**

= 15,000 shares x ₹ 10 x 20%

= ₹ 30,000 will be transferred to Profit and Loss A/c

Dividend received on shares purchased on 1st June, 20X1

= 5,000 shares x ₹10 x 20% = ₹10,000 will be adjusted to Investment A/c

*Note:* It is presumed that no dividend is received on bonus shares as bonus shares are declared on 1st July, 20X1 and dividend pertains to the year ended 31.3.20X1.

**6. Calculation of closing value of shares (on average basis) as on 31st March, 20X2**

$$13,000 \times \frac{3,39,000}{26,000} = ₹1,69,500$$

## Question 15

*The following information is presented by Mr. Z (a stock broker), relating to his holding in 9% Central Government Bonds.*

*Opening balance (nominal value) ₹1,20,000, Cost ₹1,18,000 (Nominal value of each unit is ₹100).*

| | |
|---|---|
| *1.3.20X1* | *Purchased 200 units, ex-interest at ₹98.* |
| *1.7.20X1* | *Sold 500 units, ex-interest out of original holding at ₹100.* |
| *1.10.20X1* | *Purchased 150 units at ₹98, cum interest.* |
| *1.11.20X1* | *Sold 300 units, ex-interest at ₹99 out of original holdings.* |

*Interest dates are 30th September and 31st March. Mr. Z closes his books every 31st December. Show the investment account as it would appear in his books. Mr. Z follows FIFO method.*

(*Source: Question 11, Study Material*)

**Answer**

**In the Books of Mr. Z**

**9% Central Government Bonds (Investment) Account**

| Particulars | | Nominal Value | Interest | Principal | Particulars | | Nominal Value | Interest | Principal |
|---|---|---|---|---|---|---|---|---|---|
| **20X1** | | ₹ | ₹ | ₹ | **20X1** | | ₹ | ₹ | ₹ |
| Jan.1 | To Balance b/d (W.N.1) | 1,20,000 | 2,700 | 1,18,000 | Mar. 31 | By Bank A/c (W.N.3) | - | 6,300 | - |
| March 1 | To Bank A/c (W.N.2) | 20,000 | 750 | 19,600 | July 1 | By Bank A/c (W.N.4) | 50,000 | 1,125 | 50,000 |
| July 1 | To P&L A/c (W.N.5) | - | - | 833 | Sept. 30 | By Bank A/c (W.N.6) | - | 4,050 | - |
| Oct. 1 | To Bank A/c (150 x 98) | 15,000 | - | 14,700 | Nov. 1 | By Bank A/c (W.N.7) | 30,000 | 225 | 29,700 |
| Nov. 1 | To P&L A/c (W.N.8) | - | - | 200 | Dec. 31 | By Balance c/d (W.N. 9 & W.N.10) | 75,000 | 1,688 | 73,633 |
| Dec. 31 | To P&L A/c (b.f.) (Transfer) | | 9,938 | | | | | | |
| | | 1,55,000 | 13,388 | 1,53,333 | | | 1,55,000 | 13,388 | 1,53,333 |

**Working Note:**

1. Interest element in opening balance of bonds = 1,20,000 x 9% x 3/12 = ₹2,700
2. **Purchase of bonds on 1. 3.20X1**

   Interest element in purchase of bonds = 200 x 100 x 9% x 5/12 = ₹750 Investment element in purchase of bonds = 200 x 98 = ₹19,600
3. Interest for half-year ended 31 March = 1,400 x 100 x 9% x 6/12 = ₹6,300
4. **Sale of bonds on 1.7.20X1**

   Interest element = 500 x 100 x 9% x 3/12 = ₹1,125

   Investment element = 500 x 100 = ₹50,000
5. **Profit on sale of bonds on 1.7.20X1**

   Cost of bonds = (1,18,000/ 1,200) x 500 = ₹49,167 Sale proceeds = ₹50,000

   Profit element = ₹833
6. **Interest for half-year ended 30 September**

   = 900 x 100 x 9% x 6/12 = ₹4,050
7. **Sale of bonds on 1.11.20X1**

   Interest element = 300 x 100 x 9% x 1/12 = ₹225

   Investment element = 300 x 99 = ₹29,700
8. **Profit on sale of bonds on 1.11.20X1**

   Cost of bonds = (1,18,000/ 1,200) x 300 = ₹29,500 Sale proceeds = ₹29,700

   Profit element = ₹200
9. **Closing value of investment**

| **Calculation of closing balance:** | ***Nominal value*** | | ***₹*** |
|---|---|---|---|
| Bonds in hand remained in hand at 31st December 20X1 From original holding (1,20,000 – 50,000 – 30,000) = | 40,000 | $\frac{1,18,000}{1,20,000} \times 40,000$ | 39,333 |
| Purchased on 1st March | 20,000 | | 19,600 |
| Purchased on 1st October | 15,000 | | 14,700 |
| | 75,000 | | 73,633 |

10. Interest element in closing balance of bonds = 750 x 100 x 9% x 3/12 = ₹1,688

## Question 16

*Mr. Purohit furnishes the following details relating to his holding in 8% Debentures (₹100 each) of P Ltd., held as Current assets:*

| | |
|---|---|
| *1.4.20X1* | *Opening balance – Nominal value ₹1,20,000, Cost ₹1,18,000* |
| *1.7.20X1* | *100 Debentures purchased ex-interest at ₹98* |
| *1.10.20X1* | *Sold 200 Debentures ex-interest at ₹100* |
| *1.1.20X2* | *Purchased 50 Debentures at ₹98 ex-interest* |
| *1.2.20X2* | *Sold 200 Debentures ex-interest at ₹99* |

*Due dates of interest are 30th September and 31st March.*

*Mr. Purohit closes his books on 31.3.20X2. Brokerage at 1% is to be paid for each transaction (at ex-interest price). Show Investment account as it would appear in his books. Assume FIFO method. Market value of 8% Debentures of P Limited on 31.3.20X2 is ₹99.*

(*Source: Question 12, Study Material*)

**Answer**

**Investment A/c of Mr. Purohit for the year ending on 31-3-20X2**
**(Scrip: 8% Debentures of P Limited)**
**(Interest Payable on 30th September and 31st March)**

| Date | Particulars | Nominal Value | Interest | Cost | Date | Particulars | Nominal Value | Interest | Cost |
|---|---|---|---|---|---|---|---|---|---|
| | | | ₹ | ₹ | | | | ₹ | ₹ |
| 1.4.20X1 | To Balance b/d | 1,20,000 | - | 1,18,000 | 30.9.20X1 | By Bank (1,300 x 100 x 8% x 6/12) | - | 5,200 | - |
| 1.7.20X1 | To Bank (ex-Interest) (W.N.1) | 10,000 | 200 | 9,898 | 1.10.20X1 | By Bank (W.N.4) | 20,000 | - | 19,800 |
| 1.10.20X1 | To Profit & Loss A/c (W.N.4) | | | 133 | 1.2.20X2 | By Bank (ex-Interest) (W.N.5) | 20,000 | 533 | 19,602 |
| 1.1.20X2 | To Bank (ex-Interest) (W.N.2) | 5,000 | 100 | 4,949 | 1.2.20X2 | By Profit & Loss A/c (W.N.5) | | | 64 |
| 31.3.20X2 | To Profit & Loss A/c (Bal. fig.) | - | 9,233 | | 31.3.20X2 | By Bank (950 x 100 x 8% x 6/12) | - | 3,800 | - |
| | | | | | 31.3.20X2 | By Balance c/d (W.N.3) | 95,000 | - | 93,514 |
| | | 1,35,000 | 9,533 | 1,32,980 | | | 1,35,000 | 9,533 | 1,32,980 |

**Working Notes:**

1. **Purchase of debentures on 1.7.20X1**

   Interest element = 100 x 100 x 8% x 3/12 = ₹200

   Investment element = (100 x 98) + [1% (100 x 98)] = ₹9,898

2. **Purchase of debentures on 1.1.20X2**

   Interest element = 50 x 100 x 8% x 3/12 = ₹100

   Investment element = {(50 x 98) + [1%(50 x 98)]} = ₹4,949

3. **Valuation of closing balance as on 31.3.20X2:**

   Market value of 950 Debentures at ₹99 = ₹94,050 Cost of

   800 Debentures cost = $\left(\frac{1,18,000}{1,20,000} \times 80,000\right)$=78,667

   | | | |
   |---|---|---|
   | 100 Debentures cost | = | 9,898 |
   | 50 Debentures cost | = | 4,949 |
   | | | 93,514 |
   | Value at the end | = | ₹93,514, i.e., whichever is less |

4. **Profit on sale of debentures as on 1.10.20X1**

| | ₹ |
|---|---|
| Sales price of debentures (200 x ₹100) | 20,000 |
| *Less*: Brokerage @ 1% | (200) |
| | 19,800 |
| *Less*: Cost of Debentures $\left(\frac{1,18,000}{1,20,000} \times 20,000\right) =$ | (19,667) |
| Profit on sale | 133 |

**5. Loss on sale of debentures as on 1.2.20X2**

| | ₹ |
|---|---:|
| Sales price of debentures (200 x ₹99) | 19,800 |
| *Less*: Brokerage @ 1% | (198) |
| | 19,602 |
| *Less*: Cost of Debentures $\left(\frac{1,18,000}{1,20,000} \times 20,000\right) =$ | (19,666) |
| Loss on sale | 64 |
| Interest element in sale of investment = 200 x 100 x 8% x 4/12 | ₹533 |

## Question 17

*On 1st April, 20X1, Mr. Vijay had 30,000 Equity shares in X Ltd. at a book value of ₹4,50,000 (Face Value ₹10 per share). On 22nd June, 20X1, he purchased another 5000 shares of the same company for ₹80,000.*

*The Directors of X Ltd. announced a bonus of equity shares in the ratio of one share for seven shares held on 10th August, 20X1.*

*On 31st August, 20X1 the Company made a right issue in the ratio of three shares for every eight shares held, on payment of ₹15 per share. Due date for the payment was 30th September, 20X1, Mr. Vijay subscribed to 2/3rd of the right shares and sold the remaining of his entitlement to Viru for a consideration of ₹2 per share.*

*On 31st October, 20X1, Vijay received dividends from X Ltd. @ 20% for the year ended 31st March, 20X1. Dividend for the shares acquired by him on 22nd June, 20X1 to be adjusted against the cost of purchase.*

*On 15th November, 20X1 Vijay sold 20,000 Equity shares at a premium of ₹5 per share.*

*You are required to prepare Investment Account in the books of Mr. Vijay for the year ended 31st March, 20X2 assuming the shares are being valued at average cost.*

(*Source: Question 13, Study Material*)

**Answer**

**Investment Account in Books of Vijay (Scrip: Equity Shares in X Ltd.)**

| | | ***No.*** | ***Amount*** | | | ***No.*** | ***Amount*** |
|---|---|---:|---:|---|---|---:|---:|
| | | | ₹ | | | | ₹ |
| 1.4.20X1 | To Bal b/d | 30,000 | 4,50,000 | 31.10.20X1 | By Bank (dividend on shares acquired on 22.6.20X1) | — | 10,000 |
| 22.6.20X1 | To Bank | 5,000 | 80,000 | | | | |
| 10.8.20X1 | To Bonus | 5,000 | – | | | | |
| 30.9.20X1 | To Bank (Rights Shares) | 10,000 | 1,50,000 | | | | |
| 15.11.20X1 | To P&L A/c (Profit on sale of shares) | | 32,000 | 15.11.20X1 | By Bank (Sale of shares) | 20,000 | 3,00,000 |
| | | | | 31.3.20X2 | By Bal. c/d | 30,000 | 4,02,000 |
| | | 50,000 | 7,12,000 | | | 50,000 | 7,12,000 |

**Working Notes:**

(1) **Bonus Shares** = (30,000 + 5,000) / 7 = 5,000 shares

(2) **Right Shares** $= \frac{(30,000\ 5,000\ 5,000)}{8} \times 3 = 15,000$ shares

(3) **Rights shares sold** = 15,000×1/3 = 5,000 shares

(4) **Dividend received** = 30,000×10×20% = ₹60,000 will be taken to P&L statement

**(5) Dividend on shares purchased on 22.6.20X1**

= 5,000×10×20%

= ₹10,000 is adjusted to Investment A/c

**(6) Profit on sale of 20,000 shares**

= Sales proceeds – Average cost Sales proceeds
= ₹3,00,000

$$\text{Average cost} = \frac{(4,50,000+80,000+1,50,000-10,000)}{50,000} \times 20,000$$

= ₹2,68,000

Profit = ₹3,00,000– ₹2,68,000= ₹32,000.

**(7) Cost of shares on 31.3.20X2**

$$\frac{(4,50,000+80,000+1,50,000-10,000)}{50,000} \times 30,000 = ₹4,02,000$$

**(8)** Sale of rights amounting ₹10,000 (₹2 x 5,000 shares) will not be shown in investment A/c but will directly be taken to P & L statement.

## Question 18

*Blue-chip Equity Investments Ltd., wants to re-classify its investments in accordance with AS 13 (Revised). State the values, at which the investments have to be reclassified in the following cases:*

*(i) Long term investments in Company A, costing ₹8.5 lakhs are to be re-classified as current. The company had reduced the value of these investments to ₹6.5 lakhs to recognise 'other than temporary' decline in value. The fair value on date of transfer is ₹6.8 lakhs.*

*(ii) Long term investments in Company B, costing ₹7 lakhs are to be re-classified as current. The fair value on date of transfer is ₹8 lakhs and book value is ₹7 lakhs.*

*(iii) Current investment in Company C, costing ₹10 lakhs are to be re-classified as long term as the company wants to retain them. The market value on date of transfer is ₹12 lakhs.*

(*Source: Question 14, Study Material*)

**Answer**

As per AS 13 (Revised) 'Accounting for Investments', where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer**.** And where investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹6.5 lakhs in the books.

(ii) The carrying / book value of the long term investment is same as cost i.e. ₹7 lakhs. Hence this long term investment will be reclassified as current investment at book value of ₹7 lakhs only.

(iii) In this case, reclassification of current investment into long-term investments will be made at ₹10 lakhs as cost is less than its market value of ₹12 lakhs.

# QUESTION BANK

## Question 19

On 15th June, 2018, Y limited wants to re-classify its investments in accordance with AS 13 (revised). Decided and state the amount of transfer, based on the following information:

(1) A portion of long term investments purchases on 1st March, 2017 are to be re-classified as current investments. The original cost of these investments was ₹14 lakhs but had been written down by ₹2 lakhs (to recognize 'other than temporary' decline in value). The market value of these investments on 15th June, 2018 was ₹11 lakhs.

(2) Another portion of long term investments purchases on 15th January, 2017 are to be re-classified as current investments. The original cost of these investments was ₹7 lakhs but had been written down to ₹5 lakhs (to recognize 'other than temporary' decline in value). The fair value of these investments on 15th June, 2018 was ₹4.5 lakhs.

(3) A portion of current investments purchases on 15th March, 2018 for ₹7 lakhs are to be re-classified as long term investments, as the company has decided to retain them. The market value of these investments on 31st March, 2018 was ₹6 lakhs and fair value on 15th June, 2018 was ₹8.5 lakhs.

(4) Another portion of current investments purchases on 7th December, 2017 for ₹4 lakhs are to be re-classified as long term investments. The market value of these investments was :

| | |
|---|---|
| on 31st March, 2018 | ₹3.5 lakhs |
| on 15th June, 2018 | ₹3.8 lakhs |

(*May 2019*) (*5 Marks*)

**Answer**

As per AS 13 (Revised) 'Accounting for Investments', where long-term investments are reclassified as current investments, transfers are **made at the lower of cost and carrying amount** at the date of transfer; and where investments are reclassified from current to long term, transfers are made **at lower of cost and fair value** on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹12 lakhs in the books.

(ii) In this case also, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹5 lakhs in the books.

(iii) In this case, reclassification of current investment into long-term investments will be made at ₹7 lakhs as cost is less than its fair value of ₹8.5 lakhs on the date of transfer.

(iv) In this case, market value (considered as fair value) is ₹3.8 lakhs on the date of transfer which is lower than the cost of ₹4 lakhs. The reclassification of current investment into long-term investments will be made at ₹3.8 lakhs.

## Question 20

State whether the following statements are 'True' or 'False'. Also give reason for your answer.

As per the provisions of AS-13, a current investments is an investment that is by its nature is readily realizable and is intended to be held for not more than six months from the date on which such investment is made.

(*May 2019*) (*1 Marks*)

**Answer**

**False:** A current investment is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made.

## Question 21

Paridhi Electronics Ltd. has current investment (X Ltd.'s shares) purchased for ₹5 lakhs, which the company want to reclassify as long term investment on 31.3.2018. The market value of these investments as on date of Balance Sheet was ₹2.5 lakhs. How will you deal with this as on 31.3.18 with reference to AS-13?

(*RTP May 2019*)

**Answer:**

As per AS 13 'Accounting for Investments', where investments are reclassified from current to long-term, transfers are made at the lower of cost or fair value at the date of transfer.

In the given case, the market value of the investment (X Ltd. shares) is ₹2.50 lakhs, which is lower than its cost i.e. ₹5 lakhs. Therefore, the transfer to long term investments should be made at cost of ₹2.50 lakhs. The loss of ₹2.50 lakhs should be charged to profit and loss account.

## Question 22

Paridhi Electronics Ltd. invested in the shares of another unlisted company on 1st May 2012 at a cost of ₹3,00,000 with the intention of holding more than a year. The published accounts of unlisted company received in January, 2017 reveals that the company has incurred cash losses with decline in market share and investment of Paridhi Electronics Ltd. may not fetch more than ₹45,000.

You are required to explain how you wilt deal with the above in the financial statements of the Paridhi Electronics Ltd. as on 31.3.17 with reference to AS 13?

(*RTP May 2018*)

**Answer:**

As per AS 13, "Accounting for Investments" Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. The standard also states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment.

On this basis, the facts of the case given in the question clearly suggest that the provision for diminution should be made to reduce the carrying amount of shares to ₹45,000 in the financial statements for the year ended 31st March, 2017 and charge the difference of loss of ₹2,55,000 to profit and loss account.

## Question 23

M/s Active Builders Ltd. invested in the shares of another company (with an intention to hold the shares for short term period) on 31st October, 2016 at a cost of ₹4,50,000. It also earlier purchased Gold of ₹5,00,000 and Silver of ₹2,25,000 on 31st March, 2014.

Market values as on 31st March, 2017 of the above investments are as follows:

Shares ₹3,75,000; Gold ₹7,50,000 and Silver ₹4,35,000

You are required explain how will the above investments be shown in the books of account of M/s Active Builders Ltd. for the year ending 31st March, 2017 as per the provisions of AS 13?

(*RTP November 2018*)

**Answer:**

As per AS 13 'Accounting for Investments', if the shares are purchased with an intention to hold for short-term period then investment will be shown at the realizable value. In the given case, shares purchased on 31st October, 2016, will be valued at ₹3,75,000 as on 31st March, 2017.

Gold and silver are generally purchased with an intention to hold it for long term period until and unless given otherwise. Hence, the investment in gold and silver (purchased on 31st March, 2014) shall continue to be shown at cost as on 31st March, 2017 i.e., ₹5,00,000 and ₹2,25,000 respectively, though their realizable values have been increased.

Thus the shares, gold and silver will be shown at ₹3,75,000, ₹5,00,000 and ₹2,25,000 respectively and hence, total investment will be valued at ₹11,00,000 in the books of account of M/s Active Builders for the year ending 31st March, 2017 as per provisions of AS 13.

## Question 24

Z Bank has classified its total investment on 31-3-2021 into three categories (a) held to maturity (b) available for sale (c) held for trading as per the RBI Guidelines. 'Held to maturity' investments are carried at acquisition cost less amortized amount. 'Available for sale' investments are carried at marked to market. 'Held for trading' investments are valued at weekly intervals at market rates. Net depreciation, if any, is charged to revenue and net appreciation, if any, is ignored. You are required to comment whether the policy of the bank is in accordance with AS 13?

(*MTP, November, 2021/RTP, November 2021*) (*5 Marks*)

**Answer**

As per AS 13 'Accounting for Investments', the accounting standard is not applicable to Bank, Insurance Company, Mutual Funds. In this case Z Bank is a bank, therefore, AS 13 does not apply to it. For banks, the RBI has issued separate guidelines for classification and valuation of its investment and Z Bank should comply with those RBI Guidelines/Norms. Therefore, though Z Bank has not followed the provisions of AS 13, yet it would not be said as non-compliance since, it is complying with the norms stipulated by the RBI.

## Question 25

Mr. Mohan has invested some money in various Mutual funds.

Following information in this regard is given:

| Mutual Funds | Date of purchase | Purchase cost (₹) | Brokerage Cost (₹) | Stamp duty (₹) | Market value as on 31.03.2021 (₹) |
|---|---|---|---|---|---|
| A | 01.05.2017 | 50,000 | 200 | 20 | 48,225 |
| B | 05.08.2020 | 25,000 | 150 | 25 | 24,220 |
| C | 01.01.2021 | 75,000 | 300 | 75 | 78,190 |
| D | 07.05.2020 | 70,000 | 275 | 50 | 65,880 |

You are required to;

1. Classify his investment in accordance with AS-13 (revised).
2. Value of Investment in mutual fund as on 31.03.2021

(*Suggested December 2021*) (*5 Marks*)

**Answer**

As per AS 13 "Accounting for Investments", a current investment is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost and fair value.

A long-term investment is an investment other than a current investment. Long term investments are usually carried at cost. If there is a decline, other than temporary, in the value of a long-term investment; the carrying amount is reduced to recognize the decline.

| Mutual Funds | Classification | Cost (₹) | Market value (₹) | Carrying value (₹) |
|---|---|---|---|---|
| A | Long-term Investment | 50,220 | 48,225* | 50,220 |
| B | Current Investment | 25,175 | 24,220 | 24,220 |
| C | Current Investment | 75,375 | 78,190 | 75,375 |
| D | Current Investment | 70,325 | 65,880 | 65,880 |
| Total | | | | 2,15,695 |

**Note:** ***The reduction in value of Mutual fund A is considered to be temporary. If reduction in Market value is assumed as other than temporary in nature, then the carrying value of ₹48,225 will be considered.

## Question 26

*On 1st January 20X1, Singh had 20,000 equity shares in X Ltd. Nominal value of the shares was ₹10 each but their book value was ₹ 16 per share. On 1st June 20X1, Singh purchased 5,000 more equity shares in the company at a premium of ₹ 4 per share.*

*On 30th June, 20X1, the directors of X Ltd. announced a bonus and rights issue. Bonus was declared at the rate of one equity share for every five shares held and these shares were received on 2nd August, 20X1.*

*The terms of the rights issue were:*

*(a) Rights shares to be issued to the existing holders on 10th August, 20X1.*

*(b) Rights issue would entitle the holders to subscribe to additional equity shares in the Company at the rate of one share per every three held at ₹ 15 per share-the whole sum being payable by 30th September, 20X1.*

*(c) Existing shareholders were entitled to transfer their rights to outsiders, either wholly or in part.*

*(d) Singh exercised his option under the issue for 50% of his entitlements and the balance of rights he sold to Ananth for a consideration of ₹ 1.50 per share.*

*(e) Dividends for the year ended 31st March, 20X1, at the rate of 15% were declared by the Company and received by Singh on 20th October, 20X1.*

*(f) On 1st November, 20X1, Singh sold 20,000 equity shares at a premium of ₹ 3 per share.*

*The market price of share on 31-12-20X1 was ₹ 14. Show the Investment Account as it would appear in Singh's books on 31-12-20X1 and the value of shares held on that date.*

(*Study Material*)

**Answer**

**Investment Account-Equity Shares in X Ltd.**

| *Date* | | *No. of shares* | *Dividend* | *Amount* | *Date* | | *No. of shares* | *Dividend* | *Amount* |
|---|---|---|---|---|---|---|---|---|---|
| | | | ₹ | ₹ | | | | ₹ | ₹ |
| 20X1 | | | | | 20X1 | | | | |
| Jan. 1 | To Bal. b/d | 20,000 | - | 3,20,000 | Oct. 20 | By Bank (dividend) [20,000 x 10 x 15%] [5,000 x 10 x 15%] | | 30,000 | 7,500 |
| June 1 | To Bank | 5,000 | - | 70,000 | Nov. 1 | By Bank | 20,000 | | 2,60,000 |
| Aug. 2 | To Bonus Issue | 5,000 | | — | Nov. 1 | By P & L A/c (W.N.2) | | | 1,429 |
| Sep. 30 | To Bank (Right) (W.N.1) | 5,000 | - | 75,000 | Dec. 31 | By Balance c/d (W.N.3) | 15,000 | | 1,96,071 |
| Dec.31 | To Profit & Loss A/c (Dividend income) | | 30,000 | | | | | | |
| | | 35,000 | 30,000 | 4,65,000 | | | 35,000 | 30,000 | 4,65,000 |
| Jan. 1, 20X2 | To Balance b/d | 15,000 | | 1,96,071 | | | | | |

**Working Notes:**

1. **Right shares**

   No. of right shares issued = (20,000 + 5,000 + 5,000)/ 3 = 10,000 shares No. of right shares subscribed = 10,000 x 50% = 5,000 shares

   Amount of right shares issued = 5,000 x 15 = ₹ 75,000 No. of right shares sold = 10,000 – 5,000 = 5,000 shares

   Sale of right shares = 5,000 x 1.5 = ₹ 7,500 to be credited to statement of profit and loss

2. **Cost of shares sold — Amount paid for 35,000 shares**

| | ₹ |
|---|---|
| (₹3,20,000 + ₹ 70,000 + ₹ 75,000) | 4,65,000 |
| *Less:* Dividend on shares purchased on June 1 (since the dividend pertains to the year ended 31st March, 20x1, i.e., the pre- acquisition period) | (7,500) |
| Cost of 35,000 shares | 4,57,500 |
| Cost of 20,000 shares (Average cost basis) | 2,61,429 |
| Sale proceeds | 2,60,000 |
| Loss on sale | 1,429 |

3. **Value of investment at the end of the year**

   Assuming investment as current investment, closing balance will be valued based on lower of cost or net realisable value.

   Here, Net realisable value is ₹14 per share i.e. 15,000 shares x ₹ 14 = ₹ 2,10,000 and cost = $\frac{4,57,500}{35,000} \times 15,000 =$ ₹ 1,96,071. Therefore, value of investment at the 35,000 end of the year will be ₹ 1,96,071.

## Question 27

*A Limited purchased 5,000 equity shares (nominal value ₹ 100 each) of Allianz Limited for ₹ 105 each on 1st April, 20X1. The shares were quoted cum dividend. On 15th May, 20X1, Allianz Limited declared & paid dividend of 2% for year ended 31st March, 20X1. On 30th June, 20X1 Allianz Limited issued bonus shares in ratio of 1:5. On 1st October, 20X1 Allianz Limited issued rights share in the ratio of 1:12 @ 45 per share. A Limited subscribed to half of the rights issue and the balance was sold at ₹ 5 per right entitlement. The company declared interim dividend of 1% on 30th November, 20X1. Right shares were not entitled to dividend. The company sold 3,000 shares on 31st December, 20X1 at ₹ 95 per share. The company A Ltd. incurred 2% as brokerage while buying and selling shares.*

*You are required to prepare Investment Account in books of A Ltd for the year ended 31st March, 20X2.*

(*Study Material*)

**Answer**

**In the books of A Ltd.**

**Investment in equity shares of Allianz Ltd. for the year ended 31st March, 20X2**

| *Date* | *Particulars* | *No.* | *Income* ₹ | *Amount* ₹ | *Date* | *Particulars* | *No.* | *Income* ₹ | *Amount* ₹ |
|---|---|---|---|---|---|---|---|---|---|
| 20X1 | | | | | 20X1 | | | | |
| April 1 | To Bank A/c (W.N.1) | 5,000 | - | 5,35,500 | May 15 | By Bank A/c (dividend) (W.N.6) | - | - | 10,000 |
| June 30 | To Bonus Issue (W.N 2) | 1,000 | - | - | | | | | |
| Oct. 1 | To Bank A/c (W.N. 3) | 250 | - | 11,250 | Nov. 30 | By Bank A/c (Interim dividend) (W.N.7) | - | 6,000 | - |
| Dec.31 | To P & L A/c (W.N. 5) | - | - | 21,660 | Dec. 31 | By Bank A/c (W.N. 5) | 3,000 | - | 2,79,300 |
| 20X2 | | | | | 20X2 | | | | |
| March 31 | To P & L A/c (b.f.) | - | 6,000 | - | March 31 | By Balance c/d (W.N. 7) | 3,250 | - | 2,79,110 |
| | | 6,250 | 6,000 | 5,68,410 | | | 6,250 | 6,000 | 5,68,410 |

**Working Notes:**

1. **Calculation of cost of purchase on 1st April, 20X1**

   ₹ 105 X 5,000 shares = ₹ 5,25,000

   *Add:* Brokerage (2%) = ₹ 10,500

   ₹ 5,35,500

**2. Calculation of number of bonus shares issued**

$$\text{Bonus Shares} = \frac{5,000}{5} \times 1 = 1,000$$

**3. Calculation of right shares subscribed**

$$\text{Right Shares} = \frac{6,000}{12} = 500 \text{ shares}$$

$$\text{Shares subscribed} = \frac{500}{2} = 250 \text{ shares}$$

Value of right shares subscribed = 250 shares @ ₹ 45 per share = ₹ 11,250

**4. Calculation of sale of right entitlement**

250 shares x ₹ 5 per share = ₹ 1,250

(Amount received from sale of rights will be credited to P&L a/c)

**5. Calculation of profit on sale of shares**

| | | |
|---|---|---|
| Total holding | = 5,000 shares | original |
| | 1,000 shares | bonus |
| | <u>250 shares</u> | right shares |
| | <u>6,250 shares</u> | |

3,000 shares were sold on 31.12.20X1

Cost of total holdings of 6,250 shares (on average basis)

= ₹ 5,35,500 + ₹ 11,250 – ₹ 10,000 = ₹ 5,36,750

Average cost of 3,000 shares would be

$$= \frac{5,36,750}{6,250} \times 3,000 = ₹\, 2,57,640$$

| | ₹ |
|---|---|
| Sale proceeds of 3,000 shares (3,000 x ₹ 95) | 2,85,000 |
| *Less*: 2% Brokerage | <u>(5,700)</u> |
| | 2,79,300 |
| *Less:* Cost of 3,000 shares | <u>(2,57,640)</u> |
| Profit on sale | <u>21,660</u> |

**6. Dividend received on investment held as on 15th May, 20X1**

= ₹ 10,000 (5,000 x ₹ 100 x 2%) adjusted to Investment A/c

**7. Dividend amounting ₹ 6,000 received on 30.11.20X1 will be credited to P&L A/c**

**8. Calculation of closing value of shares (on average basis) as on 31st March, 20X2**

$$= \frac{5,36,750}{6,250} \times 3,250 = ₹\, 2,79,110$$

## Question 28

*Smart Investments made the following investments in the year 20X1-X2: 12% State Government Bonds having nominal value ₹100*

| ***Date*** | ***Particulars*** |
|---|---|
| *01.04.20X1* | *Opening Balance (1200 bonds) book value of ₹ 126,000* |
| *02.05.20X1* | *Purchased 2,000 bonds @ ₹ 100 cum interest* |
| *30.09.20X1* | *Sold 1,500 bonds at ₹ 105 ex interest* |

*Interest on the bonds is received on 30th June and 31st Dec. each year.*

| ***Equity Shares of X Ltd.*** | |
|---|---|
| *15.04.20X1* | *Purchased 5,000 equity shares @ ₹ 200 on cum right basis; Brokerage of 1% (on cum-right price) was paid in addition (Nominal Value of shares ₹ 10)* |
| *03.06.20X1* | *The company announced a bonus issue of 2 shares for every 5 shares held.* |
| *16.08.20X1* | *The company made a rights issue of 1 share for every 7 shares held at ₹ 250 per share. The entire money was payable by 31.08.20X1.* |
| *22.8.20X1* | *Rights to the extent of 20% was sold @ ₹ 60. The remaining rights were subscribed.* |

| | |
|---|---|
| *02.09.20X1* | *Dividend @ 15% for the year ended 31.03.20X1 was received on 16.09.20X1* |
| *15.12.20X1* | *Sold 3,000 shares @ ₹ 300. Brokerage of 1% was incurred extra.* |
| *15.01.20X2* | *Received interim dividend @ 10% for the year 20X1 –X2* |
| *31.03.20X2* | *The shares were quoted in the stock exchange @ ₹ 220* |

*Prepare Investment Accounts in the books of Smart Investments. Assume that the average cost method is followed.*

(*Study Material*)

**Answer**

**In the books of Smart Investments**

**12% Govt. Bonds for the year ended 31st March, 20X2**

| Date | Particulars | Nos. | Interest | Amount | Date | Particulars | Nos. | Interest | Amount |
|---|---|---|---|---|---|---|---|---|---|
| 1.4.X1 | To Opening balance b/d (W.N.7) | 1,200 | 3,600 | 1,26,000 | 30.6.X1 | By Bank A/c (Interest) (3,200 x 100 x 12% x 6/12) | - | 19,200 | - |
| 2.5.X1 | To Bank A/c (W.N.8) | 2,000 | 8,000 | 1,92,000 | 30.9.X1 | By Bank A/c (W.N.1 & W.N.9) | 1,500 | 4,500 | 1,57,500 |
| 30.9.X1 | To P & L A/c (Profit on Sale) (W.N.1) | | | 8,437.50 | 31.12.X1 | By Bank A/c (Interest) (1,700 x 100 x 12% x 6/12) | - | 10,200 | - |
| 31.3.X2 | To P & L A/c (Interest) | | 27,400 | | 31.3.X2 | By Bal. c/d (W.N.2 & W.N.10) | 1,700 | 5,100 | 1,68,937.50 |
| | | 3,200 | 39,000 | 3,26,437.50 | | | 3,200 | 39,000 | 3,26,437.50 |

**Investments in Equity shares of X Ltd. for year ended 31.3.20X2**

| Date | Particulars | Nos. | Dividend | Amount | Date | Particulars | Nos. | Dividend | Amount |
|---|---|---|---|---|---|---|---|---|---|
| 15.4.X1 | To Bank A/c (W.N.3) | 5,000 | | 10,10,000 | | | | | |
| 3.6.X1 | To Bonus Issue | 2,000 | - | - | 16.9.X1 | By Bank (Dividend) (5,000 x 10 x 15%) (refer note 1 and 2) | - | - | 7,500 |
| 31.8.X1 | To Bank A/c (W.N.11) | 800 | | 2,00,000 | 15.12.X1 | By Bank (Sale) (W.N.4) | 3,000 | - | 8,91,000 |
| 15.12.X1 | To P & L A/c (W.N.5) | | | 4,28,500 | 15.1.X2 | By Bank (interim dividend) (W.N.12) | | 4,800 | |
| 31.3.X2 | To P & L A/c | | 4,800 | | 31.3.X2 | By Bal. c/d (W.N.6) | 4,800 | | 7,40,000 |
| | | 7800 | 4,800 | 16,38,500 | | | 7800 | 4,800 | 16,38,500 |

**Working Notes:**

1. **Profit on sale of bonds on 30.9.X1**
   = Sales proceeds – Average cost
   Sales proceeds = ₹1,57,500 (i.e., 1,500 x 105)
   Average cost = ₹ [(1,26,000+1,92,000) ×1,500/3,200] = 1,49,062.50 Profit = 1,57,500– ₹ 1,49,062.50=₹8,437.50
2. **Valuation of bonds on 31st March, 20X2**
   Cost = ₹3,18,000/3,200 x1,700 = 1,68,937.50
3. **Cost of equity shares purchased on 15/4/20X1**
   = Cost + Brokerage
   = (5,000 ×₹ 200) + 1% of (5,000 ×₹ 200) =₹ 10,10,000
4. **Sale proceeds of equity shares on 15/12/20X1**
   = Sale price – Brokerage
   = (3,000 ×₹ 300) – 1% of (3,000 ×₹ 300) =₹ 8,91,000.
5. **Profit on sale of shares on 15/12/20X1**
   = Sales proceeds – Average cost
   Sales proceeds = ₹ 8,91,000
   Average cost = ₹ [(10,10,000+2,00,000-7,500) × 3,000/7,800]
   = ₹ [12,02,500 × 3,000/7,800] = 4,62,500
   Profit = ₹ 8,91,000 – ₹4,62,500=₹ 4,28,500.

**6. Valuation of equity shares on 31st March, 20X2**

Cost = ₹ [12,02,500× 4,800/7,800]= ₹ 7,40,000

Market Value = 4,800 shares × ₹ 220 = ₹ 10,56,000

Closing stock of equity shares has been valued at ₹ 7,40,000 i.e. cost being lower than the market value.

**7. Interest accrued on opening balance of bonds** = 1,200 x 100 x 12% x 3/12 = ₹ 3,600

**8. Interest element in bonds purchased on 02.05.20X1**

= 2,000 x 100 x 12% x 4/12 = ₹ 8,000

Cost of investment (amount in investment column)

= (2,000 x 100) – 8,000 = ₹ 1,92,000

**9. Interest element in bonds sold on 30.09.20X1**

= 1,500 x 100 x 12% x 3/12 = ₹ 4,500

**10. Interest accrued on closing balance of bonds**

= 1,700 x 100 x 12% x 3/12 = ₹ 5,100

**11. Right shares**

No. of right shares issued = (5,000 + 2,000) x 1/7 = 1,000 shares

No. of right shares sold = 1,000 x 20% = 200 shares

Proceeds from sale of right shares to be credited to statement of profit and loss = 200 x 60 = ₹ 12,000

No. of right shares subscribed = 1,000 – 200 = 800 shares

Amount of right shares subscribed = 800 x 250 = ₹ 2,00,000

**12. Amount of interim dividend** = (5,000 + 2,000 + 800 – 3,000) x 10 x 10% = ₹ 4,800

**Note:**

1. It is presumed that no dividend is received on bonus shares as bonus shares are declared on 3.6.20X1 and dividend pertains to the year ended 31.03.20X1.
2. The amount of dividend for the period, for which shares were not held by the investor, has been treated as capital receipt.

## Question 29

*Mr. Brown has made following transactions during the financial year 20X1-X2:*

| ***Date*** | ***Particulars*** |
|---|---|
| *01.05.20X1* | *Purchased 24,000 12% Bonds of ₹100 each at ₹84 cum-interest. Interest is payable on 30th September and 31st March every year.* |
| *15.06.20X1* | *Purchased 1,50,000 equity shares of ₹10 each in Alpha Limited for ₹25 each through a broker, who charged brokerage @ 2%.* |
| *10.07.20X1* | *Purchased 60,000 equity shares of ₹10 each in Beeta Limited for ₹44 each through a broker, who charged brokerage @2%.* |
| *14.10.20X1* | *Alpha Limited made a bonus issue of two shares for every three shares held.* |
| *31.10.20X1* | *Sold 80,000 shares in Alpha Limited for ₹22 each.* |
| *01.01.20X2* | *Received 15% interim dividend on equity shares of Alpha Limited. 15.01.20X2 Beeta Limited made a right issue of one equity share for every four shares held at ₹5 per share. Mr. Brown exercised his option for 40% of his entitlements and sold the balance rights in the market at ₹2.25 per share.* |
| *01.03.20X2* | *Sold 15,000 12% Bonds at ₹90 ex-interest.* |
| *15.03.20X2* | *Received 18% interim dividend on equity shares of Beeta Limited. Interest on 12% Bonds was duly received on due dates.* |

*Prepare separate investment account for 12% Bonds, Equity Shares of Alpha Limited and Equity Shares of Beeta Limited in the books of Mr. Brown for the year ended on 31st March, 20X2.*

(*Study Material*)

**Answer**

**In the books of Mr. Brown**

**12% Bonds for the year ended 31st March, 20X2**

| *Date* | *Particulars* | *No.* | *Income ₹* | *Amount ₹* | *Date* | *Particulars* | *No.* | *Income ₹* | *Amount ₹* |
|---|---|---|---|---|---|---|---|---|---|
| 20X1 May, 1 | To Bank A/c (W.N.7) | 24,000 | 24,000 | 19,92,000 | 20X1 Sept. 30 | By Bank-Interest (24,000 x 100 × 12% x 6/12) | - | 1,44,000 | |
| 20X2 March 1 | To P & L A/c (W.N.1) | - | - | 1,05,000 | 20X2 Mar. 1 | By Bank A/c (W.N.8) | 15,000 | 75,000 | 13,50,000 |

| Date | Particulars | No. | Income ₹ | Amount ₹ | Date | Particulars | No. | Income ₹ | Amount ₹ |
|---|---|---|---|---|---|---|---|---|---|
| 20X2 March 31 | To P & L A/c (b.f.) | | 2,49,000 | | 20X2 Mar. 31 | By Bank-Interest (9,000 x 100 x 12% x 6/12) | | 54,000 | |
| | | | | | | By Balance c/d (W.N.2) | 9,000 | - | 7,47,000 |
| | | 24,000 | 2,73,000 | 20,97,000 | | | 24,000 | 2,73,000 | 20,97,000 |

**Investment in Equity shares of Alpha Ltd. for the year ended 31st March, 20X2**

| Date | Particulars | No. | Income ₹ | Amount ₹ | Date | Particulars | No. | Income ₹ | Amount ₹ |
|---|---|---|---|---|---|---|---|---|---|
| 20X1 June 15 | To Bank A/c ([1,50,000 x 25] + [2% x (1,50,000 x 25)]) | 1,50,000 | -- | 38,25,000 | 20X1 Oct. 31 | By Bank A/c | 80,000 | - | 17,60,000 |
| Oct. 14 | To Bonus Issue (1,50,000/3 x 2) | 1,00,000 | - | - | 20X2 Jan. 1 | By Bank A/c – dividend (1,70,000 x 10 x 15%) | | 2,55,000 | |
| 20X1 Oct. 31 | To P & L A/c (W.N.3) | | | 5,36,000 | March 31 | By Balance c/d (W.N.4) | 1,70,000 | - | 26,01,000 |
| 20X2 Mar. 31 | To P & L A/c | | 2,55,000 | | | | | | |
| | | 2,50,000 | 2,55,000 | 43,61,000 | | | 2,50,000 | 2,55,000 | 43,61,000 |

**Investment in Equity shares of Beeta Ltd. for the year ended 31st March, 20X2**

| Date | Particulars | No. | Income ₹ | Amount ₹ | Date | Particulars | No. | Income ₹ | Amount ₹ |
|---|---|---|---|---|---|---|---|---|---|
| 20X1 July 10 | To Bank A/c ([60,000 x 44] + [2% x (60,000 x 44)]) | 60,000 | -- | 26,92,800 | 20X2 Mar. 15 | By Bank – dividend [(60,000 + 6,000) x 10 x 18%] | - | 1,18,800 | |
| 20X2 Jan. 15 | To Bank A/c (W.N. 5) | 6,000 | - | 30,000 | March 31 | By Balance c/d (bal. fig.) | 66,000 | - | 27,22,800 |
| March 31 | To P & L A/c | - | 1,18,800 | - | | | | | |
| | | 66,000 | 1,18,800 | 27,22,800 | | | 66,000 | 1,18,800 | 27,22,800 |

**Working Notes:**

1. **Profit on sale of 12% Bond**

   Sales price ₹ 13,50,000

   *Less*: Cost of bond sold $= \frac{19,92,000}{24,000} \text{ x } 15,000$ $(₹12,45,000)$

   Profit on sale <u>₹ 1,05,000</u>

2. **Closing balance as on 31.3.20X2 of 12 % Bond**

   $$= \frac{19,92,000}{24,000} \text{ x } 9,000 = ₹7,47,000$$

3. **Profit on sale of equity shares of Alpha Ltd.**

   Sales price ₹ 17,60,000

   *Less*: Cost of bond sold = $= \frac{38,25,000}{2,50,000} \text{ x } 80,000$ $(₹12,24,000)$

   Profit on sale <u>₹ 5,36,000</u>

4. **Closing balance as on 31.3.20X2 of equity shares of Alpha Ltd.**

   $$= \frac{38,25,000}{2,50,000} \text{ x } 1,70,000 \qquad = (₹\ 26,01,000)$$

5. **Calculation of right shares subscribed by Beeta Ltd.**

   $$\text{Right Shares} = \frac{60,000 \text{ shares}}{4} \text{ x } 1 = 15,000 \text{ shares}$$

   Shares subscribed by Mr. Brown = 15,000 x 40%= 6,000 shares

   Value of right shares subscribed = 6,000 shares @ ₹ 5 per share = ₹ 30,000

6. **Calculation of sale of right entitlement by Beeta Ltd.**
   No. of right shares sold = 15,000 - 6,000 = 9,000 shares
   Sale value of right = 9,000 shares x ₹ 2.25 per share = ₹ 20,250
   **Note:** As per para 13 of AS 13, sale proceeds of rights is to be credited to P & L A/c.
7. **Purchase of bonds on 01.05.20X1**
   Interest element in purchase of bonds = 24,000 x 100 x 12% x 1/12 = ₹ 24,000 Investment element in purchase of bonds = (24,000 x 84) – 24,000 = ₹ 19,92,000
8. **Sale of bonds on 01.03.20X2**
   Interest element in purchase of bonds = 15,000 x 100 x 12% x 5/12 = ₹ 75,000 Investment element in purchase of bonds = 15,000 x 90 = ₹ 13,50,000

## Question 30

Following transactions of Nisha took place during the financial year 2017-18:

| | |
|---|---|
| 1st April, 2017 | Purchased 9,000 8% bonds of ₹100 each at ₹80.50 cum-interest. Interest is payable on 1st November and 1st May. |
| 1st May, 2017 | Received half year's interest on 8% bonds. |
| 10th July, 2017 | Purchased 12,000 equity shares of ₹10 each in Moon Limited for ₹44 each through a broker, who charged brokerage @ 2%. |
| 1st October, 2017 | Sold 2,250 8% bonds at ₹81 Ex-interest. |
| 1st November, 2017 | Received half year's interest on 8% bonds. |
| 15th January, 2018 | Moon Limited made a rights issue of one equity share for every four Equity shares held at ₹5 per share. Nisha exercised the option for 40% of her entitlements and sold the balance rights in the market at ₹2.25 per share. |
| 15th March, 2018 | Received 18% interim dividend on equity shares of Moon Limited. |

Prepare separate investment account for 8% bonds and equity shares of Moon Limited in the books of Nisha for the year ended on 31st March, 2018. Assume that the average cost method is followed.

(*November 2018*) (*10 Marks*)

**Answer:**

**In the books of Nisha**
**8% Bonds for the year ended 31st March, 2018**

| *Date* | *Particulars* | *No.* | *Income* ₹ | *Amount* ₹ | *Date* | *Particulars* | *No.* | *Income* ₹ | *Amount* ₹ |
|---|---|---|---|---|---|---|---|---|---|
| 2017 1 April, | To Bank A/c | 9,000 | 30,000 | 6,94,500 | 1 May 2017 | By Bank-Interest | - | 36,000 | |
| Oct. 1 2018 | To P & L A/c (W.N .1) | - | - | 8,625 | 1 Oct. 2017 | By Bank A/c | 2,250 | 7,500 | 1,82,250 |
| March 31 | | | | | 1 Nov. 2018 | By Bank-Interest | | 27,000 | |
| | To P & L A/c | | 40,500 | | | | | | |
| | | | | | 2018 Mar. 31 | By Balance c/d (W.N .2) | 6,750 | - | 5,20,875 |
| | | 9,000 | 70,500 | 7,03,125 | | | 9,000 | 70,500 | 7,03,125 |

**Investment in Equity shares of Moon Ltd. for the year ended 31st March, 2018**

| *Date* | *Particulars* | *No.* | *Income* ₹ | *Amount* ₹ | *Date* | *Particulars* | *No.* | *Income* ₹ | *Amount* ₹ |
|---|---|---|---|---|---|---|---|---|---|
| 2017 July 10 | To Bank A/c | 12,000 | — | 5,38,560 | 2018 March 15 | By Bank – dividend * | — | 23,760 | |
| 2018 Jan. 15 | To Bank A/c (W.N. 3) | 1,200 | — | 6,000 | March 31 | By Balance c/d (bal. fig.) | 13,200 | — | 5,44,560 |
| March 31 | To P & L A/c | — | 23,760 | | | | | | |
| | | 13,200 | 23,760 | 5,44,560 | | | 13,200 | 23,760 | 5,44,560 |

***** Considering that dividend was received on right shares also.

**Working Notes:**

1. **Profit on sale of 8% Bonds**

| | |
|---|---|
| Sales price | ₹ 1,82,250 |
| *Less*: Cost of bond sold = 6,94,500/9,000x 2,250 | (₹ 1,73,625) |
| Profit on sale | ₹ 8,625 |

2. **Closing balance as on 31.3.2018 of 8 % Bonds**
   6,94,500/ 9,000 x 6,750= ₹ 5,20,875
3. **Calculation of right shares subscribed by Moon Ltd.**
   Right Shares = 12,000/4 x 1= 3,000 shares
   Shares subscribed by Nisha = 3,000 x 40%= 1,200 shares
   Value of right shares subscribed = 1,200 shares @ ₹ 5 per share = ₹ 6,000
4. **Calculation of sale of right entitlement by Moon Ltd.**
   No. of right shares sold = 3,000 – 1,200 = 1,800 rights for ₹ 4,050
   **Note:** As per para 13 of AS 13, sale proceeds of rights are to be credited to P & L A/c.

## Question 31

A Ltd. purchased on 1st April, 2018 8% convertible debenture in C Ltd. of face value of ₹ 2,00,000 @ ₹ 108. On 1st July, 2018 A Ltd. purchased another ₹ 1,00,000 debenture @ ₹ 112 cum interest.

On 1st October, 2018 ₹ 80,000 debenture was sold @ ₹ 105. On 1st December, 2018, C Ltd. give option for conversion of 8% convertible debentures into equity share of ₹ 10 each. A Ltd. receive 5,000 equity share in C Ltd. in conversion of 25% debenture held on that date. The market price of debenture and equity share in C Ltd. at the end of year 2018 is ₹ 110 and ₹ 15 respectively.

Interest on debenture is payable each year on 31st March, and 30th September.

The accounting year of A Ltd. is calendar year.

Prepare investment account in the books of A Ltd. on average cost basis.

(*RTP May 2019*) (*MTP April, 2022, 8 Marks*)

**Answer:**

**Investment Account for the year ending on 31st December, 2018**
**Scrip : 8% Convertible Debentures in C Ltd.**
**[Interest Payable on 31st March and 30th September]**

| Date | Particulars | Nominal value (₹) | Interest (₹) | Cost (₹) | Date | Particulars | Nominal Value (₹) | Interest (₹) | Cost (₹) |
|---|---|---|---|---|---|---|---|---|---|
| 1.4.18 | To Bank A/c | 2,00,000 | - | 2,16,000 | 30.09.18 | By Bank A/c | - | 12,000 | - |
| 1.7.18 | To Bank A/c (W.N .1) | 1,00,000 | 2,000 | 1,10,000 | | [₹3,00,000 x 8% x (6/12] | | | |
| 31.12.18 | To P & L A/c [Interest] | - | 14,033 | - | 1.10.18 | By Bank A/c | 80,000 | | 84,000 |
| | | | | | 1.10.18 | By P&L A/c (loss) (W.N .1) | | | 2,933 |
| | | | | | 1.12.18 | By Bank A/c (Accrued interest) (₹ 55,000 x .08 x 2/12) | | 733 | |
| | | | | | 1.12.18 | By Equity shares in C Ltd. (W.N . 3 and 4) | 55,000 | | 59,767 |
| | | | | | 31.12.18 | By Balance c/d (W.N .5) | 1,65,000 | 3,300 | 1,79,300 |
| | | 3,00,000 | 16,033 | 3,26,000 | | | 3,00,000 | 16,033 | 3,26,000 |

**SCRIP: Equity Shares in C LTD.**

| Date | Particulars | Cost (₹) | Date | Particulars | Cost (₹) |
|---|---|---|---|---|---|
| 1.12.18 | T o 8 % debentures | 59,767 | 31.12.18 | By balance c /d | 59,767 |

**Working Notes:**

(i) Cost of Debenture purchased on 1st July = ₹1,12,000 – ₹2,000 (Interest) = ₹1,10,000

(ii) Cost of Debentures sold on 1st Oct.
= (₹2,16,000 + ₹1,10,000) x 80,000/3,00,000 = ₹ 86,933

(iii) Loss on sale of Debentures = ₹ 86,933– ₹84,000 = ₹2,933
Nominal value of debentures converted into equity shares = ₹ 55,000
[(₹ 3,00,000 – 80,000) x.25]
Interest received before the conversion of debentures
Interest on 25% of total debentures = 55,000 x 8% x 2/12 = 733

(iv) Cost of Debentures converted = (₹ 2,16,000 + ₹1,10,000) x 55,000/3,00,000
= ₹ 59,767

(v) Cost of closing balance of Debentures = (₹ 2,16,000 + ₹1,10,000) x 1,65,000 / 3,00,000
= ₹ 1,79,300

(vii) Closing balance of Debentures has been valued at cost being lower than the market value i.e. ₹ 1,81,500 (₹ 1,65,000 @ ₹ 110)

(viii) 5,000 equity Shares in C Ltd. will be valued at cost of ₹ 59,767 being lower than the market value ₹ 75,000 (₹ 15 x5,000)

**Note:** It is assumed that interest on debentures, which are converted into cash, has been received at the time of conversion.

## Question 32

Akash Ltd. had 4,000 equity share of X Limited, at a book value of ₹ 15 per share (face value of ₹ 10 each) on 1st April 2017. On 1st September 2017, Akash Ltd. acquired 1,000 equity shares of X Limited at a premium of ₹ 4 per share. X Limited announced a bonus and right issue for existing shareholders.

The terms of bonus and right issue were—

(1) Bonus was declared, at the rate of two equity shares for every five equity shares held on 30th September, 2017.

(2) Right shares are to be issued to the existing shareholders on 1st December, 2017. The company issued two right shares for every seven shares held at 25% premium. No dividend was payable on these shares. The whole sum being payable by 31st December, 2017.

(3) Existing shareholders were entitled to transfer their rights to outsiders, either wholly or in part.

(4) Akash Ltd. exercised its option under the issue for 50% of its entitlements and sold the remaining rights for ₹ 8 per share.

(5) Dividend for the year ended 31st March 2017, at the rate of 20% was declared by the company and received by Akash Ltd., on 20th January 2018.

(6) On 1st February 2018, Akash Ltd., sold half of its shareholdings at a premium of ₹ 4 per share.

(7) The market price of share on 31.03.2018 was ₹ 13 per share.

You are required to prepare the Investment Account of Akash Ltd. for the year ended 31st March, 2018 and determine the value of share held on that date assuming the investment as current investment. Consider average cost basis for ascertainment of cost for equity share sold.

(*RTP November 2018*)

**Answer:**

**Investment Account-Equity Shares in X Ltd.**

| Date | | No. of shares | Dividend | Amount | Date | | No. of shares | Dividend | Amount |
|---|---|---|---|---|---|---|---|---|---|
| | | ₹ | ₹ | ₹ | | | ₹ | ₹ | ₹ |
| 2017 | | | | | 2018 | | | | |
| April 1 | To Balance b/d | 4,000 | - | 60,000 | Jan. 20 | By Bank (dividend) | | 8,000 | 2,000 |
| Sept 1 | To Bank | 1,000 | - | 14,000 | Feb.1 | By Bank | 4,000 | | 56,000 |
| Sept.30 | To Bonus Issue | 2,000 | | — | Mar. 31 | By Balance c/d | 4,000 | | 42,250 |
| Dec.1 | To Bank (Right) | 1,000 | - | 12,500 | | | | | |
| 2018 | | | | | | | | | |
| Feb. 1 | To Profit & Loss A/c | | | 13,750 | | | | | |
| Mar. 31 | To Profit & Loss A/c (Dividend income) | | 8,000 | | | | | | |
| | | 8,000 | 8,000 | 1,00,250 | | | 8,000 | 8,000 | 1,00,250 |
| April. 1 | To Balance b/d | 4,000 | | 42,250 | | | | | |

**Working Notes:**

**1. Cost of shares sold — Amount paid for 8,000 shares**

| | ₹ |
|---|---|
| (₹ 60,000 + ₹ 14,000 + ₹ 12,500) | 86,500 |
| Less: Dividend on shares purchased on 1st Sept, 2017 | (2,000) |
| Cost of 8,000 shares | 84,500 |
| Cost of 4,000 shares (Average cost basis*) | 42,250 |
| Sale proceeds (4,000 shares @ 14) | 56,000 |
| Profit on sale | 13,750 |

* For ascertainment of cost for equity shares sold, average cost basis has been applied.

**2. Value of investment at the end of the year**

Closing balance will be valued based on lower of cost (₹ 42,250) or net realizable value (₹13 × 4,000). Thus investment will be valued at ₹ 42,250.

**3. Calculation of sale of right entitlement**

1,000 shares × ₹ 8 per share = ₹ 8,000

Amount received from sale of rights will be credited to P & L A/c as per AS 13 'Accounting for Investments'.

**4. Dividend received on investment held as on 1st April, 2017**

= 4,000 shares × ₹ 10 × 20%

= ₹ 8,000 will be transferred to Profit and Loss A/c

**Dividend received on shares purchased on 1st Sep. 2017**

= 1,000 shares × ₹ 10 × 20% = ₹ 2,000 will be adjusted to Investment A/c

**Note**: It is presumed that no dividend is received on bonus shares as bonus shares are declared on 30st Sept., 2017 and dividend pertains to the year ended 31.3.2017.

## Question 33

Alpha Ltd. purchased 5,000, 13.5% Debentures of Face Value of ₹ 100 each of Pergot Ltd. on 1st May 2017 @ ₹ 105 on cum interest basis. The interest on these instruments is payable on 31st & 30th of March & September respectively. On August 1st 2017 the company again purchased 2,500 of such debentures @ ₹ 102.50 each on cum interest basis. On October 1st, 2017 the company sold 2,000 Debentures @ ₹ 103 each on ex-interest basis. The market value of the debentures as at the close of the year was ₹ 106. You are required to prepare the Investment in Debentures Account in the books of Alpha Ltd. for the year ended 31st Dec. 2017 on Average Cost Basis.

(*RTP May 2018*)

**Answer:**

**8. Books of Alpha Ltd.**

**Investment in 13.5% Debentures in Pergot Ltd. Account**

**(Interest payable on 31st March & 30th September)**

| Date | Particulars | Nominal | Interest | Amount | Date | Particulars | Nominal | Interest | Amount |
|---|---|---|---|---|---|---|---|---|---|
| **2017** | | ₹ | ₹ | ₹ | **2017** | | ₹ | ₹ | ₹ |
| May 1 | To Bank | 5,00,000 | 5,625 | 5,19,375 | Sept.30 | By Bank (6 months Int) | | 50,625 | |
| Aug.1 | To Bank | 2,50,000 | 11,250 | 2,45,000 | Oct.1 | By Bank | 2,00,000 | | 2,06,000 |
| Oct.1 | To P&L A/c | | | 2,167 | | | | | |
| Dec.31 | To P&L A/c | | 52,313 | | Dec.31 | By Balance c/d | 5,50,000 | 18,563 | 5,60,542 |
| | | 7,50,000 | 69,188 | 7,66,542 | | | 7,50,000 | 69,188 | 7,66,542 |

**Note**: Cost being lower than Market Value the debentures are carried forward at Cost.

**Working Notes:**

1. Interest paid on ₹ 5,00,000 purchased on May 1st, 2017 for the month of April 2017, as part of purchase price: 5,00,000 x 13.5% x 1/12 = ₹ 5,625
2. Interest received on 30th Sept. 2017
   On ₹ 5,00,000 = 5,00,000 x 13.5% x 1/2 = 33,750
   On ₹ 2,50,000 = 2,50,000 x 13.5% x 1/2 = 16,875
   Total ₹ 50,625
3. Interest paid on ₹ 2,50,000 purchased on Aug. 1st 2017 for April 2017 to July 2017 as part of purchase price: 2,50,000 x 13.5% x 4/12 = ₹ 11,250
4. Loss on Sale of Debentures Cost of acquisition
   (₹ 5,19,375 + ₹ 2,45,000) x ₹ 2,00,000/₹ 7,50,000 = 2,03,833
   Less: Sale Price (2,000 x 103) = 2,06,000
   Profit on sale = ₹ 2,167
5. Cost of Balance Debentures
   (₹ 5,19,375 + ₹ 2,45,000) x ₹ 5,50,000/₹ 7,50,000 = ₹ 5,60,542
6. Interest on Closing Debentures for period Oct.-Dec. 2017 carried forward (accrued interest)
   ₹ 5,50,000 x 13.5% x 3/12 = ₹ 18,563

## Question 34

In 2015, Royal Ltd. issued 12% fully paid debentures of ₹ 100 each, interest being payable half yearly on 30th September and 31st March of every accounting year.

On 1st December, 2016, M/s. Kumar purchased 10,000 of these debentures at ₹101 cum-interest price, also paying brokerage @ 1% of cum-interest amount of the purchase. On 1st March, 2017 the firm sold all of these debentures at ₹106 cum-interest price, again paying brokerage @ 1 % of cum-interest amount. Prepare Investment Account in the books of M/s. Kumar for the period 1st December, 2016 to 1st March, 2017.

(*MTP March 2019*) (*6 Marks*)

**Answer:**

**In the books of M/s Kumar**
**Investment Account**
**for the period from 1st December 2016 to 1st March, 2017**
**(Scrip: 12% Debentures of Royal Ltd.)**

| Date | Particulars | Nominal Value (₹) | Interest | Cost (₹) | Date | Particulars | Nominal Value (₹) | Interest | Cost (₹) |
|---|---|---|---|---|---|---|---|---|---|
| 1.12.2016 | To Bank A/c (W.N .1) | 10,00,000 | 20,000 | 10,00,100 | 1.03.2017 | By Bank A/c (W.N .2) | 10,00,000 | 50,000 | 9,99,400 |
| 1.3.2017 | To Profit & loss A/c | - | 30,000 | | 1.3.2017 | By Profit & loss A/c | | | 700 |
| | | 10,00,000 | 50,000 | 10,00,100 | | | 10,00,000 | 50,000 | 10,00,100 |

**Working Notes:**

| | | ₹ |
|---|---|---|
| (i) | Cost of 12% debentures purchased on 1.12.2016 | |
| | Cost Value (10,000 × ₹101) | = 10,10,000 |
| | *Add:* Brokerage (1% of ₹10,10,000) | = 10,100 |
| | *Less:* Cum Interest (10,000 x 100 x12% x 2/12) | = (20,000) |
| | Total | = 10,00,100 |
| (ii) | Sale proceeds of 12% debentures sold on 1st March, 2017 | ₹ |
| | Sales Price (10,000 × ₹106) | = 10,60,000 |
| | *Less:* Brokerage (1% of ₹10,60,000) | = (10,600) |
| | *Less:* Cum Interest (10,000 x 100 x12% x 5/12) | = (50,000) |
| | Total | = 9,99,400 |

## Question 35

Gopal holds 2,000, 15% Debentures of ₹ 100 each in Ritu Industries Ltd. as on April 1, 2015 at a cost of ₹2,10,000. Interest is payable on June, 30 and December, 31 each year. On May 1, 2015, 1,000 debentures are purchased cum-interest at ₹ 1,07,000. On November 1, 2015, 1,200 debentures are sold ex-interest at ₹1,14,600. On November 30, 2015, 800 debentures are purchased ex-interest at ₹ 76,800. On December 31, 2015, 800 debentures are sold cum-interest for ₹ 1,10,000. You are required to prepare the Investment Account showing value of holdings on March 31, 2016 at cost, using FIFO Method.

(*MTP April 2019*) (*10 Marks*)

**Answer:**

**Investment Account of Gopal**
**For the year ended 31.3.2016**
**(Script: 15% Debentures in Ritu Industries Ltd.)**
**(Interest payable on 30th June and 31st December)**

| Date | Particulars | Nominal Value ₹ | Interest ₹ | Cost ₹ | Date | Particulars | Nominal Value ₹ | Interest ₹ | Cost ₹ |
|---|---|---|---|---|---|---|---|---|---|
| 1.04.15 | To Balance A/c | 2,00,000 | 7,500 | 2,10,000 | 30.06.15 | By Bank A/c | - | 22,500 | |
| 1.05.15 | To Bank A/c | 1,00,000 | 5,000 | 1,02,000 | 1.11.15 | By Bank A/c | 1,20,000 | 6,000 | 1,14,600 |
| 30.11.15 | To Bank A/c | 80,000 | 5,000 | 76,800 | 1.11.15 | By Profit & Loss A/c | - | - | 11,400 |
| 31.12.15 | To Profit & Loss A/c | | | 20,000 | 31.12.15 | By Bank A/c | 80,000 | 6,000 | 1,04,000 |
| 31.03.16 | To Profit & Loss A/c | | 37,250 | | 31.12.15 | By Bank A/c | - | 13,500 | - |
| | (Bal. fig.) | | | | 31.12.15 | By Bank A/c | - | 6,750 | - |
| | | | | | 31.3.16 | By Bal. c/d | 1,80,000 | - | 1,78,800 |
| | | 3,80,000 | 54,750 | 4,08,800 | | | 3,80,000 | 54,750 | 4,08,800 |

**Working Notes:**

(i) Accrued Interest as on 1st April, 2015 = $₹ 2,00,000 \times \frac{15}{100} \times \frac{3}{12} = ₹ 7,500$

(ii) Accrued Interest as on 1.5.2015 = ₹ $1,00,000 \times \frac{15}{100} \times \frac{4}{12} = ₹ 5,000$

(iii) Cost of Investment for purchase on 1st May = ₹ 1,07,000 – ₹ 5,000 = ₹ 1,02,000

(iv) Interest received as on 30.6.2015 = ₹ $3,00,000 \times \frac{15}{100} \times \frac{6}{12} = ₹ 22,500$

(v) Accrued Interest on debentures sold on 1.11.2015= ₹ $1,20,000 \times \frac{15}{100} \times \frac{4}{12} = ₹ 6,000$

(vi) Accrued Interest = ₹ $80,000 \times \frac{15}{100} \times \frac{5}{12} = ₹ 5,000$

(vii) Accrued Interest on sold debentures 31.12.2015 = ₹ $80,000 \times \frac{15}{100} \times \frac{6}{12} = ₹ 6,000$

(viii) Sale Price of Investment on 31st Dec. = ₹ 1,10,000 – ₹ 6,000 = ₹ 1,04,000

(ix) Loss on Sale of Debenture on 1.1.2015

| | |
|---|---|
| Sale Price of Debenture | 1,14,600 |
| *Less:* Cost Price of debenture | |
| $\frac{2,10,000}{2,00,000} \times ₹ 1,20,000$ | 1,26,000 |
| Loss on sale | 11,400 |

(x) Accrued interest as on 31.12.2015 = ₹ $1,80,000 \times \frac{15}{100} \times \frac{6}{12} = ₹ 13,500$

(xi) Accrued Interest = ₹ $1,80,000 \times \frac{15}{100} \times \frac{3}{12} = ₹ 6,750$

(xii) Cost of investment as on 31st Marc h = ₹ 1,02,000 + ₹ 76,800 = ₹ 1,78,800

(xiii) Profit on debentures sold on 31st Dec ember
= ₹ 1,04,000 –(₹ 2,10,000x800/2,000) =₹ 20,000

## Question 36

Meera carried out the following transactions in the shares of Kumar Ltd.:

(1) On 1st April, 2017 she purchased 40,000 equity shares of ₹ 1 each fully paid up for ₹ 60,000.

(2) On 15th May 2017, Meera sold 8,000 shares for ₹ 15,200.

(3) At a meeting on 15th June 2017, the company decided:

(i) To make a bonus issue of one fully paid up share for every four shares held on 1st June 2017, and

(ii) To give its members the right to apply for one share for every five shares held on 1st June 2017 at a price of ₹ 1.50 per share of which 75 paise is payable on or before 15th July 2017 and the balance, 75 paise per share, on or before 15th September, 2017.

The shares issued under (i) and (ii) were not to rank for dividend for the year ending 31st December 2017.

(a) Meera received her bonus shares and took up 4000 shares under the right issue, paying the sum thereon when due and selling the rights of the remaining shares at 40 paise per share; the proceeds were received on 30 th September 2017.

(b) On 15th March 2018, she received a dividend from Kumar Ltd. of 15 per cent in respect of the year ended 31st Dec 2017.

(c) On 30th March, 2018 she received ₹ 28,000 from the sale of 20,000 shares.

You are required to record these transactions in the Investment Account in Meera’s books for the year ended 31st March 2018 transferring any profits or losses on these transactions to Profit and Loss account. Apply average cost basis. Expenses and tax to be ignored.

(*MTP October, 2018*) (*8 Marks*)

**Answer:**

**In the books of Meera Investment Account (Shares in Kumar Limited)**

| Date | Particulars | No. of Shares | Income | Amount | Date | Particulars | No. of Shares | Income | Amount |
|---|---|---|---|---|---|---|---|---|---|
| **2017** | | | ₹ | ₹ | **2017** | | | ₹ | ₹ |
| April 1 | To Bank (Purchases) | 40,000 | - | 60,000 | May | By Bank (Sale) | 8,000 | - | 15,200 |
| May | To Profit & Loss A/c (W.N.1) | - | - | 3,200 | | | | | |
| June | To Bonus Issue | 8,000 | - | Nil | 2018 | | | | |
| July | To Bank (@ 75 p. paid on 4,000 shares) | 4,000 | - | 3,000 | Mar. 15 | By Bank (Dividend @ 15% on ₹ 32,000) | | 4,800 | - |
| Sept. | To Bank (@ 75 p. paid on 4,000 shares) | - | - | 3,000 | Mar. 30 | By Bank (Sale) | 20,000 | - | 28,000 |
| 2018 Mar. 31 | To Profit & Loss A/c (W.N.2) | | | 3,455 | Mar. 31 | By Balance c/d $\left(\frac{24,000}{44,000} \times 54,000\right)$ | 24,000 | - | 29,455 |
| | To Profit & Loss A/c | - | 4,800 | | | | | | |
| | | 52,000 | 4,800 | 72,655 | | | 52,000 | 4,800 | 72,655 |

**Working Notes:**

| | | | |
|---|---|---|---|
| **(1)** | **Profit on Sale on 15-5-2017:** | | |
| | Cost of 8,000 shares @ ₹1.50 | ₹ 12,000 | |
| | *Less*: Sales price | ₹ 15,200 | |
| | Profit | | ₹ 3,200 |
| **(2)** | **Cost of 20,000 shares sold:** | | |
| | Cost of 44,000 shares (48,000 + 6,000) | | ₹ 54,000 |
| | $\therefore$ Cost of 20,000 shares $\left(\frac{\text{Rs.} 54,000}{44,000} \times 20,000 \text{ shares}\right)$ | | ₹ 24,545 |
| | Profit on sale of 20,000 shares (₹ 28,000 – ₹ 24,545) | | ₹ 3,455 |

## Question 37

A Pvt. Ltd. follows the calendar year for accounting purposes. The company purchased 5,000 (nos.) 13.5% Convertible Debentures of Face Value of ₹ 100 each of P Ltd. on 1st May 2018 @ ₹ 105 on cum interest basis. The interest on these instruments is payable on 31st March & 30th September respectively. On August 1st 2018 the company again purchased 2,500 of such debentures @ ₹ 102.50 each on cum interest basis. On 1st October, 2018 the company sold 2,000 Debentures @ ₹ 103 each. On 31st December, 2018 the company received 10,000 equity shares of ₹ 10 each in P Ltd. on conversion of 20% of its holdings. Interest for 3 months on converted debentures was also received on 31.12.2018. The market value of the debentures and equity shares as at the close of the year were ₹ 106 and ₹ 9 respectively. Prepare the Debenture Investment Account & Equity Shares Investment Account in the books of A Pvt. Ltd. for the year 2018 on Average Cost Basis.

(*RTP November 2019*)

**Answer**

**Books of A Pvt. Ltd.**

**Investment in 13.5% Convertible Debentures in P Ltd. Account**

**(Interest payable 31st March & 30th September)**

| *Date* | *Particulars* | *Nominal* | *Interest* | *Amount* | *Date* | *Particulars* | *Nominal* | *Interest* | *Amount* |
|---|---|---|---|---|---|---|---|---|---|
| | | ₹ | ₹ | ₹ | | | ₹ | ₹ | ₹ |
| 2018 | | | | | 2018 | | | | |
| May 1 | To Bank | 5,00,000 | 5,625 | 5,19,375 | Sept. 30 | By Bank (6 months Int) | | 50,625 | |
| Aug.1 | To Bank | 2,50,000 | 11,250 | 2,45,000 | Oct.1 | By Bank | 2,00,000 | | 2,06,000 |
| Oct.1 | To P&L A/c | | | 2,167 | | | | | |
| Dec. 31 | To P&L A/c | | 52,313 | | Dec. 31 | By Equity share | 1,10,000 | | 1,12,108 |
| | | | | | Dec. 31 | By Bank (See note1) | | 3,713 | |
| | | | | | Dec. 31 | By Balance c/d | 4,40,000 | 14,850 | 4,48,434 |
| | | 7,50,000 | 69,188 | 7,66,542 | | | 7,50,000 | 69,188 | 7,66,542 |

Note 1: ₹ 3,713 received on 31.12.2018 represents interest on the debentures converted till date of conversion.
Note 2: Cost being lower than Market Value the debentures are carried forward at Cost.

**Investment in Equity shares in P Ltd. Account**

| *Date* | *Particulars* | *Nominal* | *Amount* | *Date* | *Particulars* | *Nominal* | *Amount* |
|---|---|---|---|---|---|---|---|
| | | ₹ | ₹ | | | ₹ | ₹ |
| 2018 | | | | 2018 | | | |
| Dec 31 | To 13.5% Deb. | 1,00,000 | 1,12,108 | Dec.31 | By P&L A/c | | 22,108 |
| | | | | Dec.31 | By Bal. c/d | 1,00,000 | 90,000 |
| | | 1,00,000 | 1,12,108 | | | 1,00,000 | 1,12,108 |

Note 1: Cost being higher than Market Value the shares are carried forward at Market Value.

**Working Notes:**

1. Interest paid on ₹ 5,00,000 purchased on May 1st, 2018 for the month of April 2018, as part of purchase price: 5,00,000 x 13.5% x 1/12 = ₹ 5,625
2. Interest received on 30th Sept. 2018
On ₹ 5,00,000 = 5,00,000 x 13.5% x ½ = 33,750
On ₹ 2,50,000 = 2,50,000 x 13.5% x ½ = 16,875
Total ₹ 50,625
3. Interest paid on ₹ 2,50,000 purchased on Aug. 1st 2018 for April 2018 to July 2018 as part of purchase price: 2,50,000 x 13.5% x 4/12 = ₹ 11,250
4. Loss on Sale of Debentures Cost of acquisition
(₹ 5,19,375 + ₹ 2,45,000) x ₹ 2,00,000/₹ 7,50,000 = 2,03,833
*Less*: Sale Price (2,000 x 103) = 2,06,000
Profit on sale = ₹ 2,167
5. Interest on 1,100 Debentures (being those converted) for 3 months i.e. Oct-Dec. 2018 1,10,000 x 13.5% x 3/12 = ₹ 3,713
6. Cost of Debentures converted to Equity Shares
(₹ 5,19,375 + ₹ 2,45,000) x 1,10,000/7,50,000= ₹ 1,12,108
7. Cost of Balance Debentures
(₹ 5,19,375 + ₹ 2,45,000) x ₹ 4,40,000/₹ 7,50,000 = ₹ 4,48,434
8. Interest on Closing Debentures for period Oct.- Dec. 2018 carried forward (accrued interest)
₹ 4,40,000 x 13.5% x 3/12 = ₹ 14,850

## Question 38

Mr. Harsh provides the following details relating to his holding in 10% debentures (face value of ₹100 each) of Exe Ltd., held as current assets:

| | |
|---|---|
| **1.4.2018** | opening balance - 12,500 debentures, cost ₹12,25,000 |
| 1.6.2018 | purchased 9,000 debentures @ ₹98 each ex-interest |
| 1.11.2018 | purchased 12,000 debentures @ ₹115 each cum-interest |
| 31.1.2019 | sole 13,500 debentures @ ₹110 each cum-interest |
| 31.3.2019 | Market value of debentures @ ₹115 each |

Due dates of interest are 30th June and 31st December
Brokerage at 1% is to be paid for each transaction. Mr. Harsh closes his books on 31.3.2019.
Show investment account as it would appear in his books assuming FIFO method is followed

(*Suggested November 2019*) (*10 Marks*)/(*RTP May 2022*)

**Answer**

**Investment Account of Mr. Harsh for the year ending on 31-3-2019**
**(Scrip: 10% Debentures of Exe Limited)**
**(Interest Payable on 30th June and 31st December)**

| Date | Particulars | Nominal Value ₹ | Interest ₹ | Cost ₹ | Date | Particulars | Nominal Value ₹ | Interest ₹ | Cost ₹ |
|---|---|---|---|---|---|---|---|---|---|
| 1.4.18 | To Balance b/d | 12,50,000 | 31,250 | 12,25,000 | 30.6.18 | By Bank 21,500 x 100 x 10% x 1/2 | - | 1,07,500 | - |
| 1.6.18 | To Bank (ex-Interest) (W.N.1) | 9,00,000 | 37,500 | 8,90,820 | 31.12.19 | By Bank 33,500 x 100x10% x 1/2 | | 1,67,500 | |

| Date | Particulars | Nominal Value ₹ | Interest ₹ | Cost ₹ | Date | Particulars | Nominal Value ₹ | Interest ₹ | Cost ₹ |
|---|---|---|---|---|---|---|---|---|---|
| 1.11.18 | To Bank (cum-Interest) (W.N.2) | 12,00,000 | 40,000 | 13,53,800 | 31.1.19 | By Bank (W.N.3) | 13,50,000 | 11,250 | 14,58,900 |
| 31.1.19 | To Profit & Loss A/c (W.N.3) | | | 1,34,920 | 31.3.19 | By Balance c/d (W.N.4) | 20,00,000 | 50,000 | 21,45,640 - |
| 31.3.19 | To Profit & Loss A/c (Bal. fig.) | | 2,27,500 | | | | | | |
| | | 33,50,000 | 3,36,250 | 36,04,540 | | | 33,50,000 | 3,36,250 | 36,04,540 |

**Working Notes:**

1. **Purchase of debentures on 1.6.18**
   Interest element = 9,000 x 100 x 10% x 5/12 = ₹ 37,500
   Investment element = (9,000 x 98) + [1%(9,000 x 98)] = ₹ 8,90,820
2. **Purchase of debentures on 1.11.2018**
   Interest element = 12,000 x 100 x 10% x 4/12 = ₹ 40,000
   Investment element = 12,000 X 1 15 X 101% less 40,000 = ₹ 13,53,800
3. **Profit on sale of debentures as on 31.1.19**

| | ₹ |
|---|---|
| Sales price of debentures (13,500 x ₹ 110) | 14,85,000 |
| Less: Brokerage @ 1% | (14,850) |
| | 14,70,150 |
| Less: Interest (1,35,000/ 12) | (11,250) |
| | 14,58,900 |
| Less: Cost of Debentures [(12,25,000 + (890820 X 1,00,000/ 9,00,000)] | (13,23,980) |
| Profit on sale | 1,34,920 |

4. **Valuation of closing balance as on 31.3.2019:**
   Market value of 20,000 Debentures at ₹ 115 = ₹ 23,00,000
   Cost of
   8,000 Debentures = 8,90,820/ 9,000 X 8,000 = 7,91,840
   12,000 Debentures = 13,53,800
   Total 21,45,640
   Value at the end is ₹ 21,45,640, i.e., which is less than market value of ₹ 23,00,000.

## Question 39

(a) In 2018, Royal Ltd. issued 12% fully paid debentures of ₹ 100 each, interest being payable half yearly on 30th September and 31st March of every accounting year. On 1st December, 2019, M/s. Kumar purchased 10,000 of these debentures at ₹ 101 (cum-interest) price. On 1st March, 2020 the firm sold all of these debentures at ₹ 106 (cum-interest) price.

You are required to prepare Investment (Debentures) Account in the books of M/s. Kumar for the period 1st December, 2019 to 1st March, 2020.

(b) Mr. X acquires 200 shares of a company on cum-right basis for ₹ 60,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at ₹ 105 each. He does not subscribe but sells all the rights for ₹ 15,000. The market value of the shares after their becoming ex-rights has also gone down to ₹ 50,000. What should be the accounting treatment in this case?

[*RTP, November 2020*]

**Answer**

**(a) Investment Account in the books of M/s Kumar for the period from 1st December 2019 to 1st March, 2020**

**(Scrip: 12% Debentures of Royal Ltd.)**

| Date | Particulars | Nominal Value (₹) | Interest | Cost (₹) | Date | Particulars | Nominal Value (₹) | Interest | Cost (₹) |
|---|---|---|---|---|---|---|---|---|---|
| 1.12.2019 | To Bank A/c (W.N.1) | 10,00,000 | 20,000 | 9,90,000 | 1.03.2020 | By Bank A/c (W.N.2) | 10,00,000 | 50,000 | 10,10,000 |
| 1.3.2020 | To Profit & loss A/c | | 30,000 | 20,000 | | | | | |
| | | 10,00,000 | 50,000 | 10,10,000 | | | 10,00,000 | 50,000 | 10,10,000 |

**Working Notes:**

| | | | |
|---|---|---|---|
| (i) | Cost of 12% debentures purchased on 1.12.2019 | | ₹ |
| | Cost Value (10,000 x ₹101) | = | 10,10,000 |
| | *Less:* Interest (10,000 x 100 x12% x 2/12) | = | (20,000) |
| | Total | = | 9,90,000 |
| (ii) | Sale proceeds of 12% debentures sold on 1st March, 2020 Sales Price (10,000 x ₹106) | | ₹ |
| | | = | 10,60,000 |
| | *Less:* Interest (10,000 x 100 x12% x 5/12) | = | (50,000) |
| | Total | = | 10,10,000 |

**(b)** As per AS 13, where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value. In this case, the amount of the ex-right market value of 200 shares bought by X immediately after the declaration of rights falls to ₹50,000. In this case, out of sale proceeds of ₹ 15,000, ₹ 10,000 may be applied to reduce the carrying amount to bring it to the market value ₹50,000 and ₹ 5,000 would be credited to the profit and loss account.

## Question 40

On 1st April, 2019, Mr. Vijay had 30,000 Equity shares in X Ltd. (the company) at a book value of ₹ 4,50,000 (Face Value ₹ 10 per share). On 22nd June, 2019, he purchased another 5000 shares of the same company for ₹ 80,000.

The Directors of X Ltd. announced a bonus of equity shares in the ratio of one share for seven shares held on 10th August, 2019.

On 31st August, 2019 the Company made a right issue in the ratio of three shares for every eight shares held, on payment of ₹ 15 per share. Due date for the payment was 30th September, 2019, Mr. Vijay subscribed to 2/3rd of the right shares and sold the remaining of his entitlement to Viru for a consideration of ₹ 2 per share.

On 31stOctober,2019, Vijay received dividends from X Ltd. @ 20% for the year ended 31st March, 2019. Dividend for the shares acquired by him on 22ndJune,2019 to be adjusted against the cost of purchase.

On 15th November, 2019 Vijay sold 20,000 Equity shares at a premium of ₹ 5 per share.

You are required to prepare Investment Account in the books of Mr. Vijay for the year ended 31st March, 2020 assuming the shares are being valued at average cost.

*(10 Marks) (MTP, May 2020)*

**Answer:**

**Books of Vijay**
**Investment Account**
**(Scrip: Equity Shares in X Ltd.)**

| | | No. | Amount | | | No. | Amount |
|---|---|---|---|---|---|---|---|
| | | | ₹ | | | | ₹ |
| 1.4.2019 | To Bal b/d | 30,000 | 4,50,000 | 31.10.2019 | By Bank (dividend on shares acquired on 22/6/2019) | — | 10,000 |
| 22.6.2019 | To Bank | 5,000 | 80,000 | | | | |
| 10.8.2019 | To Bonus | 5,000 | - | | | | |
| 30.9.2019 | To Bank (Rights Shares) | 10,000 | 1,50,000 | | | | |
| 15.11.2019 | To Profit (on sale of shares) | | 32,000 | 15.11.2019 | By Bank (Sale of shares) | 20,000 | 3,00,000 |
| | | | | 31.3.2020 | By Bal. c/d | 30,000 | 4,02,000 |
| | | 50,000 | 7,12,000 | | | 50,000 | 7,12,000 |

**Working Notes:**

(1) Bonus Shares = (30,000 + 5,000) / 7 = 5,000 shares

(2) Right Shares $= \frac{(30,000 + 5,000 + 5,000)}{8} \times 3 = 15,000\text{shares}$

(3) Rights shares sold = 15,000×1/3 = 5,000 shares

(4) Dividend received = 30,000×10×20% = ₹60,000 will be taken to P&L statement

(5) Dividend on shares purchased on 22.6.2019= 5,000×10×20% = ₹ 10,000 is adjusted to Investment A/c

(6) Profit on sale of 20,000 shares

= Sales proceeds – Average cost Sales proceeds = ₹ 3,00,000

Average cost = $= \frac{(4,50,000 + 80,000 + 1,50,000 - 10,000)}{50,000} \times 20,000 = \text{Rs.}2,68,000$

Profit = ₹ 3,00,000– ₹2,68,000= ₹32,000.

(7) Cost of shares on 31.3.2018

$$= \frac{(4,50,000 + 80,000 + 1,50,000 - 10,000)}{50,000} \times 30,000 = \text{Rs.}4,02,000$$

(8) Sale of rights amounting ₹ 10,000 (₹ 2 x 5,000 shares) will not be shown in investment A/c but will directly be taken to P & L statement.

## Question 41

P Ltd. had 8,000 equity shares of K Ltd., at a book value of ₹ 15 per share (face value of ₹ 10 each) on 1st April, 2019. On 1st September, 2019, P Ltd. acquired another 2,000 equity shares of K Ltd. at a premium of ₹4 per share. K Ltd. announced a bonus and right issue for existing shareholders.

The term of bonus and right issue were:

- (i) Bonus was declared at the rate for two equity shares for every five shares held on 30th September, 2019.
- (ii) Right shares are to be issued to the existing shareholders on 1st December, 219. The Company had issued two right shares for every seven shares held at 25% premium on face value. No dividend was payable on these shares. The whole sum being payable by 31st December, 2019.
- (iii) Existing shareholders were entitled to transfer their right to outsiders either wholly or in part.
- (iv) P Ltd. exercised its option under the issue for 50% of its entitlements and sold the remaining rights for ₹8 per share.
- (v) Dividend for the year ended 31st March, 2019 at the rate of 20% was declared by K Ltd. and received by P Ltd. on 20th January, 2020.
- (vi) On 1st February, 2020, P Ltd. sold half of its shareholdings at a premium of ₹ 4 per share.
- (vii) The market price of share on 31st March, 2020 was ₹13 per share.

You are required to prepare the Investment account of P Ltd. for the year ended 31st March,2020 and determine the value of shares held on that date, assuming the investment as current investment. Consider average cost basis for ascertainment for cost for equity shares sold. (*Suggested, January, 2021*) (*10 marks*)

**Answer**

**Investment Account-Equity Shares in K Ltd.**

| *Date* | | *No. of shares* | *Dividend* | *Amount* | *Date* | | *No. of shares* | *Dividend* | *Amount* |
|---|---|---|---|---|---|---|---|---|---|
| | | | ₹ | ₹ | | | | ₹ | ₹ |
| 1.4.19 | To Bal.b/d | 8,000 | - | 1,20,000 | 20.1.20 | By Bank (dividend) [8,000 x 10 x 20%] and [2,000 x 10 x 20%] | | 16,000 | 4,000 |
| 1.9.19 | To Bank | 2,000 | - | 28,000 | 1.2.20 | By Bank | 8,000 | | 1,12,000 |
| 30.9.19 | To Bonus Issue | 4,000 | | — | | | | | |
| 31.12.19 | To Bank (Right) (W.N.1) | 2,000 | - | 25,000 | 31.3.20 | By Balance c/d (W.N. 3) | 8,000 | | 84,500 |
| 20.1.20 | To Profit & Loss A/c (Dividend income) | | 16,000 | | | | | | |
| 1.2.20 | To P& L A/c (profit on sale) | | | 27,500 | | | | | |
| | | 16,000 | 16,000 | 2,00,500 | | | 16,000 | 16,000 | 2,00,500 |

**Working Notes:**

**1. Right shares**

No. of right shares issued = (8,000 + 2,000 + 4,000)/ 7 X 2= 4,000 No. of right shares subscribed = 4,000 x 50% = 2,000 shares Value of right shares issued = 2,000 x ₹12.50 = ₹ 25,000

No. of right shares sold = 2,000 shares

Sale of right shares = 2,000 x ₹ 8 = ₹ 16,000 to be credited to statement of profit and loss

**2. Cost of shares sold — Amount paid for 16,000 shares**

| | ₹ |
|---|---|
| (₹1,20,000 + ₹ 28,000 + ₹ 25,000) | 1,73,000 |
| *Less:* Dividend on shares purchased on Sept. 1 (since the dividend pertains to the year ended 31st March, 2019, i.e., the pre-acquisition period) | (4,000) |
| Cost of 16,000 shares | 1,69,000 |
| Cost of 8,000 shares (Average cost basis) | 84,500 |
| Sale proceeds (8,000 X ₹14) | 1,12,000 |
| Profit on sale | 27,500 |

**3. Value of investment at the end of the year**

Assuming investment as current investment, closing balance will be valued based on lower of cost or net realizable value.

Here, Net realizable value is ₹13 per share i.e., 8,000 shares x ₹ 13 = ₹ 1,04,000 and cost = 84,500. Therefore, value of investment at the end of the year will be ₹ 84,500.

## Question 42

On 1st April, 2019 Mr. Shyam had an opening balance of 1000 equity shares of X Ltd ₹ 1,20,000 (face value ₹100 each).

On 5.04.2019 he further purchased 200 cum-right shares for ₹ 135 each. On 8.04.2019 the director of X Ltd announced right issue in the ratio of 1:6.

Mr. Shyam waived off 100% of his entitlement of right issue in the favour of Mr. Rahul at the rate of ₹ 20 each.

All the shares held by Shyam had been acquired on cum right basis and the total market price (ex-right) of all these shares after the declaration of rights got reduced by ₹ 3,400.

On 10.10.2019 Shyam sold 350 shares for ₹ 140 each. 31.03.2020 The market price of each share is ₹ 125 each.

You are required to prepare the Investment account in the books of Mr. Shyam for the year ended 31.03.2020 assuming that the shares are being valued at average cost. (*RTP, May 2021*)

**Answer**

**In the books of Mr. Shyam**

**for the year ending on 31-3-2020 (Scrip: Equity Shares of X Limited)**

| Date | Particulars | Qty | Amount | Date | Particulars | Qty | Amount |
|---|---|---|---|---|---|---|---|
| 1.4.2019 | To Balance b/d | 1000 | 1,20,000 | 8.04.2019 | By Bank A/c (W.N.1) | | 3,400 |
| 5.04.2019 | To Bank (200x ₹135) | 200 | 27,000 | 10.10.2019 | By Bank A/c (350x ₹140) | 350 | 49,000 |
| 10.10.2019 | To Profit & Loss A/c (W.N.2) | | 7,117 | 31.3.2020 | By Balance c/d (W.N.3) | 850 | 1,01,717 |
| | | 1200 | 1,54,117 | | | 1200 | 1,54,117 |

**Working Notes:**

**1.** Sale of Rights ₹ 4,000

The market price of all shares of X Ltd after shares becoming ex-rights has been reduced by ₹ 3,400

In this case out of sale proceeds of ₹4,000; ₹ 3,400 may be applied to reduce the carrying amount to the market value and ₹ 600 would be credited to the profit and loss account.

**2. Profit on sale of 350 shares**

| | Amount |
|---|---|
| Sale price of 350 shares (350 shares X 140 each) | ₹ 49,000 |
| Less: Cost of 350 shares [(1,20,000+27,000-3,400) X350]/1200 | ₹ 41,883 |
| Profit | ₹ 7,117 |

**3. Valuation of 850 shares as on 31.03.2020**

| Particulars | Amount |
|---|---|
| Cost price of 850 shares [(1,20,000 +27,000 -3,400) x 850 /1,200] | ₹ 1,01,717 |
| Fair Value as on 31.03.2020 [850 X ₹ 125 each] | ₹ 1,06,250 |
| Cost price or fair value whichever is less | ₹ 1,01,717 |

## Question 43

On 1st April, 2019 Mr. H had 30,000 equity shares of ABC Ltd. at book value of ₹ 18 per share (Nominal value 10 per share). On 10th June, 2019, H purchased another 10,000 equity shares of the ABC ltd. at ₹ 16 per share through a broker who charged 1.5% brokerage.

The directors of ABC Ltd. announced a bonus and a right issue. The terms of the issues were as follows:

(i) Bonus shares were declared at the rate of one equity share for every four shares held on 15th July, 2019.

(ii) Right shares were to be issued to the existing equity shareholders on 31st August, 2019. The company decides to issue one right share for every five equity shares held at 20% premium and the due date for payment will be 30th September, 2019. Shareholders were entitled to transfer their rights in full or in part.

(iii) No dividend was payable on these issues.

Mr. H subscribed 60% of the rights entitlements and sold the remaining rights for consideration of ₹ 5 per share.

Dividends for the year ending 31st March, 2019 was declared by ABC Ltd. at the rate of 20% and received by Mr. H on 31st October, 2019.

On 15th January, 2020 Mr. H sold half of his shareholdings at ₹ 17.50 per share and brokerage was charged @1%.

You are required to prepare Investment account in the books of Mr. H for the year ending 31st March, 2020, assuming the shares are valued at average cost.

(*10 Marks*) (*Suggested November 2020*)

**Answer**

**In the books of Mr. H**

**Investment in equity shares of ABC Ltd. for the year ended 31st March, 2020**

| Date | Particulars | No. | Income ₹ | Amount ₹ | Date | Particulars | No. | Income ₹ | Amount ₹ |
|---|---|---|---|---|---|---|---|---|---|
| 2019 April 1 | To Balance b/d | 30,000 | - | 5,40,000 | 2019 Oct. | By Bank A/c (W.N. 5) | - | 60,000 | 20,000 |
| June | To Bank A/c | 10,000 | -- | 1,62,400 | 20X2 Jan. | By Bank A/c (W.N.4) | 28,000 | - | 4,85,100 |
| July | To Bonus Issue (W.N. 1) | 10,000 | - | - | March 31 | By Balance c/d (W.N. 6) | 28,000 | - | 3,77,200 |
| Sept. | To Bank A/c (W.N. 2) | 6,000 | - | 72,000 | | | | | |
| 2020 Jan. | To P & L A/c (W.N. 4) | - | - | 1,07,900 | | | | | |
| March 31 | To P & L A/c | - | 60,000 | - | | | | | |
| | | 56,000 | 60,000 | 8,82,300 | | | 56,000 | 60,000 | 8,82,300 |

**Working Notes:**

**1.** Calculation of no. of bonus shares issued

Bonus Shares = (30,000 + 10,000) divided by 4= 10,000 shares

**2.** Calculation of right shares subscribed

$$\text{Right Shares} = \frac{30{,}000\text{ shares} + 10{,}000\text{ shares} + 10{,}000\text{ shares}}{5}$$

10,000 shares

Shares subscribed 10,000 x 60% = 6,000 shares

Value of right shares subscribed = 6,000 shares @ ₹ 12 per share = ₹ 72,000

**3.** Calculation of sale of right entitlement

Amount received from sale of rights will be 4,000 shares x ₹ 5 per share

= ₹ 20,000 and it will be credited to statement of profit and loss.

**4.** Calculation of profit/loss on sale of shares-

Total holding = 30,000 shares original

10,000 shares purchased

10,000 shares bonus

<u>6,000</u> shares right shares

<u>56,000</u>

50% of the holdings were sold i.e. 28,000 shares (56,000 x1/2) were sold. Cost of total holdings of 56,000 shares = ₹ 5,40,000 + ₹ 1,62,400 + ₹ 72,000– ₹ 20,000 = ₹ 7,54,400

Average cost of shares sold would be:

$$= \frac{7{,}54{,}400 \times 28{,}000}{56{,}000} \times 28{,}000 = ₹3{,}77{,}200$$

| | ₹ |
|---|---|
| Sale proceeds of 28,000 shares (28,000 x ₹17.50) | 4,90,000 |
| *Less*: 1% Brokerage | (4,900) |
| | 4,85,100 |
| *Less:* Cost of 28,000 shares sold | (3,77,200) |
| Profit on sale | 1,07,900 |

**5.** Dividend received on investment held as on 1st April, 2019

= 30,000 shares x ₹ 10 x 20%

= ₹ 60,000 will be transferred to Profit and Loss A/c and Dividend received on shares purchased on 10th June, 2019

= 10,000 shares x ₹ 10 x 20% = ₹20,000 will be adjusted to Investment A/c

**6.** Calculation of closing value of shares (on average basis) as on 31st March, 2020

$$\frac{7,54,400}{56,000} \times 28,000 = ₹\,3,77,200$$

## Question 44

Remo Ltd. held on 1st April, 2021, 1000 9% Government Securities at ₹ 90,000 (Face Value of Security ₹ 100 each). Three month's interest had accrued on the above date. On 1st May, the company purchased the same Government Securities of the face value of ₹ 80,000 at ₹ 95 cum-interest. On 1st June, ₹ 60,000 face value of the security was sold at ₹ 94 cum-interest. Interest on the security was paid each year on 30th June and 31st December and was credited by the bank on the same date. On 30th September, ₹ 40,000 face value of the Govt. securities were sold at ₹ 97 cum-interest. On 1st December, the company purchased the same security ₹ 10,000 at par ex-interest. On 1st March, the company sold ₹ 10,000 face value of the government securities at ₹ 95 ex- interest.

You are required to draw up the 9% Government Security Account in the books of Remo Limited. FIFO method shall be followed.

Calculation shall be made to the nearest rupee or multiple thereof.

(*RTP May, 2023*)

**Answer**

**In the Books of Remo Ltd.**
**9% Government Securities (Investment) Account**

| ***Particulars*** | | ***Face Value*** | ***Interest*** | ***Cost*** | ***Particulars*** | | ***Face Value*** | ***Interest*** | ***Cost*** |
|---|---|---|---|---|---|---|---|---|---|
| ***2021*** | | ***₹*** | ***₹*** | ***₹*** | ***2021*** | | ***₹*** | ***₹*** | ***₹*** |
| April 1 | To Balance b/d | 1,00,000 | 2,250 | 90,000 | June 1 | By Bank A/c | 60,000 | 2,250 | 54,150 |
| May 1 | To Bank A/c | 80,000 | 2,400 | 73,600 | June 30 | By Bank A/c | - | 5,400 | - |
| June 1 | To P&L A/c | - | - | 150 | Sept. 30 | By Bank A/c | 40,000 | 900 | 37,900 |
| Sept. 30 | To P & L A/c | - | - | 1,900 | Dec. 31 | By Bank A/c | - | 4,050 | - |
| Dec. 1 | To Bank A/c | 10,000 | 375 | 10,000 | Mar.1 2022 | By Bank A/c | 10,000 | 150 | 9,500 |
| Mar. 1 2022 | To P&L A/c | - | - | 300 | Mar. 31 2022 | By Balance c/d | 80,000 | 1,800 | 74,400 |
| Mar. 31, 2022 | To P&L A/c (Transfer) | - | 9,525 | - | | | | | |
| | | 1,90,000 | 14,550 | 1,75,950 | | | 1,90,000 | 14,550 | 1,75,950 |

**Working Notes:**

1. Interest accrued on 1st April 2021 = ₹1,00,000 x 9% x 3/12 = ₹ 2,250
2. Accrued Interest on 800 units as on 01 05.2021 = ₹ 80,000 x 9/100 x 4/12 = ₹ 2,400
3. Cost of Investment for purchase on 01.05.2021 = ₹ 76,000 - ₹ 2,400 = ₹ 73,600
4. Accrued Interest on 600 units as on 01 06.2021 = ₹ 60,000 x 9/100 x 5/12 = ₹ 2,250
5. Profit on Securities sold on 1st June = ₹ 54,150 (56,400 – 2,250)- ₹ 54,000 (60,000 x 90,000/1,00,000) = ₹ 150
6. Interest received on 30 06.2021 = ₹1,20,000 x 9/100 x 6/12 = ₹ 5,400
7. Accrued Interest on 400 units as on 30 09.2021 = ₹ 40,000 x 9/100 x 3/12 = ₹ 900
8. Cost of 400 Govt. Securities sold on 30.09.2021 = 40,000 x 90,000/1,00,000 = ₹ 36,000
9. Profit on securities sold on 30th September = ₹37,900 (38,800-900) - ₹ 36,000 = ₹ 1,900
10. Accrued Interest on 1 12.2021 = ₹ 10,000 x 9/100 x 5/12 = ₹ 375
11. Interest received on 31 12.2021 = ₹ 90,000 x 9/100 x 6/12 = ₹ 4,050
12. Accrued Interest on 100 units as on 01 03.2022 = ₹ 10,000 x 9/100 x 2/12 = ₹ 150
13. Cost of 100 Govt. Securities sold on 01.03.2022 = ₹ 10,000 x 73,600/80,000 = ₹ 9,200
14. Profit on securities sold on 01.03.2022 = ₹ 9,500 - ₹ 9,200 = ₹ 300
15.

| **Calculation of closing balance:** | ***Units*** | ***₹*** |
|---|---|---|
| Securities in hand remained in hand at 31/3/2022 | | |
| From original holding (1,00,000 – 60,000 – 40,000) | | - |
| Purchased on 1st May (80,000 – 10,000) | 70,000 | 64,400 |
| Purchased on 1st December | 10,000 | 10,000 |
| | 80,000 | 74,400 |

## Question 45

The following information is given for Mr. Atwood for the year ended 31.03.2023 :

| | |
|---|---|
| 01.04.2022 | Mr. Atwood has ₹3,000 equity shares in Sun Limited at a book value of ₹3,30,000 (nominal value ₹ 100 each). |
| 01.07.2022 | Purchased ₹1,500 equity shares in Sun Limited for ₹1,38,600. |
| 01.08.2022 | Purchased ₹5,000, 9% Bonds at ₹97 cum-interest (face value ₹100). The due dates of interest are 1st September and 1sl March. |
| 02.10.2022 | Dividend declared on equity shares and paid by Sun Limited for the year 2021-2022 @ 10%. |
| 15.10.2022 | Sun Limited made a bonus issue of two equity shares for every five shares held. |
| 01.01.2023 | ₹1,000 equity shares in Sun Limited sold @ ₹115 per share. |
| 31.03.2023 | Sold 4,000, 9% Bonds @ ₹99 ex-interest |

- The market price of Equity Shares of Sun Limited is ₹125 each and Bonds ₹98 each on 31st March 2023.
- Interest on bonds was received on due dates.

You are required to prepare Investment Account in the books of Mr. Atwood for the year ended 31st March 2023, assuming that the investments are valued at the average cost or market value, whichever is lower. (Round off to nearest Rupee)

(*G-I, May, 2023*) (*10 Marks*)

CHAPTER
# 12

# Accounting Standard 19 Leases

## Question 1

*S. Square Private Limited has taken machinery on finance lease from S.K. Ltd. The information is as under:*

*Lease term = 4 years*

*Fair value at inception of lease = ₹20,00,000 Lease rent = ₹6,25,000 p.a. at the end of year Guaranteed residual value = ₹1,25,000 Expected residual value = ₹3,75,000*

*Implicit interest rate = 15%*

*Discounted rates for 1st year, 2nd year, 3rd year and 4th year are 0.8696, 0.7561,*

*0.6575 and 0.5718 respectively.*

*Calculate the value of the lease liability as per AS-19 and disclose impact of this on Balance sheet and Profit & loss account at the end of year 1*

(*Source: Illustration 1, Study Material*)

**Answer**

According to para 11 of AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the lower of the fair value of the leased asset at the inception of the finance lease and the present value of the minimum lease payments from the standpoint of the lessee.

In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease. Present value of minimum lease payments will be calculated as follows:

| Year | Minimum Lease Payment ₹ | Implicit interest rate (Discount rate @15%) | Present value ₹ |
|---|---|---|---|
| 1 | 6,25,000 | 0.8696 | 5,43,500 |
| 2 | 6,25,000 | 0.7561 | 4,72,563 |
| 3 | 6,25,000 | 0.6575 | 4,10,937 |
| 4 | 7,50,000 | 0.5718 | 4,28,850 |
| Total | 26,25,000 | | 18,55,850 |

Present value of minimum lease payments ₹18,55,850 is less than fair value at the inception of lease i.e. ₹20,00,000, therefore, the asset and corresponding lease liability should be recognised at ₹18,55,850 as per AS 19.

## Question 2

*Prakash Limited leased a machine to Badal Limited on the following terms:*

| | | *(₹ In lakhs)* |
|---|---|---|
| *(i)* | *Fair value of the machine* | *28.3* |
| *(ii)* | *Lease term* | *5 years* |
| *(iii)* | *Lease rental per annum* | *8.00* |
| *(iv)* | *Guaranteed residual value* | *1.60* |
| *(v)* | *Expected residual value* | *3.00* |
| *(vi)* | *Internal rate of return* | *15%* |

*Discounted rates for 1st year to 5th year are 0.8696, 0.7561, 0.6575, 0.5718, and 0.4972 respectively.*

*Ascertain Unearned Finance Income.*

(*Source: Illustration 2, Study Material*)

**Answer**

As per AS 19 on Leases, ***unearned finance income*** is the difference between (a) the ***gross investment*** in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

Where:

(a) ***Gross investment*** in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

***Gross investment*** = Minimum lease payments + Unguaranteed residual value

= [Total lease rent + Guaranteed residual value (GRV)] + Unguaranteed residual value (URV)

= [(₹8,00,000 × 5 years) + ₹1,60,000] + ₹1,40,000

= ₹43,00,000 (a)

(b) Table showing present value of (i) Minimum lease payments (MLP) and

(ii) Unguaranteed residual value (URV).

| Year | MLP inclusive of URV ₹ | Internal rate of return (Discount factor @ 15%) | Present Value ₹ |
|---|---|---|---|
| 1 | 8,00,000 | 0.8696 | 6,95,680 |
| 2 | 8,00,000 | 0.7561 | 6,04,880 |
| 3 | 8,00,000 | 0.6575 | 5,26,000 |
| 4 | 8,00,000 | 0.5718 | 4,57,440 |
| 5 | 8,00,000 | 0.4972 | 3,97,760 |
| | 1,60,000 (GRV) | 0.4972 | 79,552 |
| | 41,60,000 | | 27,61,312 (i) |
| | 1,40,000 (URV) | 0.4972 | 69,608 (ii) |
| | 43,00,000 | (i)+ (ii) | 28,30,920 (b) |

Unearned Finance Income (a) - (b) = ₹43,00,000 – ₹28,30,920= ₹14,69,080.

## Question 3

*A Ltd. sold machinery having WDV of ₹40 lakhs to B Ltd. for ₹50 lakhs and the same machinery was leased back by B Ltd. to A Ltd. The lease back is operating lease. Comment if –*

(a) Sale price of ₹50 lakhs is equal to fair value.

(b) Fair value is ₹60 lakhs.

(c) Fair value is ₹45 lakhs and sale price is ₹38 lakhs.

(d) Fair value is ₹40 lakhs and sale price is ₹50 lakhs.

(e) Fair value is ₹46 lakhs and sale price is ₹50 lakhs

(f) Fair value is ₹35 lakhs and sale price is ₹39 lakhs.

(*Source: Illustration 3, Study Material*)

**Answer**

Following will be the treatment in the given cases:

(a) When sales price of ₹50 lakhs is equal to fair value, A Ltd. should immediately recognise the profit of ₹10 lakhs (i.e. 50 – 40) in its books.

(b) When fair value is ₹60 lakhs then also profit of ₹10 lakhs should be immediately recognised by A Ltd.

(c) When fair value of leased machinery is ₹45 lakhs & sales price is ₹38 lakhs, then loss of ₹2 lakhs (40 – 38) to be immediately recognised by A Ltd. in its books provided loss is not compensated by future lease payment, otherwise defer and amortise the loss.

(d) When fair value is ₹40 lakhs & sales price is ₹50 lakhs then, profit of ₹10 lakhs is to be deferred and amortised over the lease period.

(e) When fair value is ₹46 lakhs & sales price is ₹50 lakhs, profit of ₹6 lakhs (46 - 40) to be immediately recognised in its books and balance profit of ₹4 lakhs (50-46) is to be amortised/deferred over lease period.

(f) When fair value is ₹35 lakhs & sales price is ₹39 lakhs, then the loss of ₹5 lakhs (40-35) to be immediately recognised by A Ltd. in its books and profit of ₹4 lakhs (39-35) should be amortised/deferred over lease period.

## Question 4

*Explain the types of lease as per AS 19.*

(*Source: Question 6, Study Material*)

**Answer**

For the purpose of accounting AS 19, classifies leases into two categories as follows:

1. Finance Lease
2. Operating Lease

**Finance Lease:**

It is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership.

As per para 8 of the standard, in following situations, the lease transactions are called Finance lease:

1. The lessee will get the ownership of leased asset at the end of the lease term.
2. The lessee has an option to buy the leased asset at the end of the lease term at price, which is lower than its expected fair value at the date on which option will be exercised.
3. The lease term covers the major part of the life of asset even if title is not transferred.
4. At the beginning of lease term, present value of minimum lease rental covers the initial fair value.
5. The asset given on lease to lessee is of specialized nature and can only be used by the lessee without major modification.

***Operating Lease:***

It is lease, which does not transfer all the risks and rewards incidental to ownership.

## Question 5

*Explain the accounting treatment for a sale and leaseback transaction under Operating lease.*

(*Source: Question 7, Study Material*)

**Answer**

As per AS 19, where sale and leaseback results in operating lease, then the accounting treatment in different situations is as follows:

Situation 1: Sale price = Fair Value

Profit or loss should be recognized immediately. Situation 2: Sale Price < Fair Value

Profit should be recognized immediately. The loss should also be recognized immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used.

Situation 3: Sale Price > Fair Value

The excess over fair value should be deferred and amortized over the period for which the asset is expected to be used.

## Question 6

*What do you understand by the term "Interest rate implicit on lease"?*

(*Source: Question 8, Study Material*)

**Answer**

As per para 3 of AS 19 'Leases' the interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of:

(a) the minimum lease payments under a finance lease from the standpoint of the lessor; and

(b) any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.

## Question 7

*What are the disclosures requirements for operating leases by the lessee as per AS-19?*

(*Source: Question 9, Study Material*)

**Answer**

As per AS 19, lessees are required to make following disclosures for operating leases:

(a) the total of future minimum lease payments under non-cancelable operating leases for each of the following periods:
   (i) not later than one year;
   (ii) later than one year and not later than five years;
   (iii) later than five years;

(b) the total of future minimum sublease payments expected to be received under non- cancelable subleases at the balance sheet date;

(c) lease payments recognized in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;

(d) sub-lease payments received (or receivable) recognized in the statement of profit and loss for the period;

(e) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:
   (i) the basis on which contingent rent payments are determined;
   (ii) the existence and terms of renewal or purchase options and escalation clauses; and
   (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

## Question 8

*Classify the following into either operating or finance lease:*

*(i) Lessee has option to purchase the asset at lower than fair value, at the end of lease term;*

*(ii) Economic life of the asset is 7 years, lease term is 6 years, but asset is not acquired at the end of the lease term;*

*(iii) Economic life of the asset is 6 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee;*

*(iv) Present value (PV) of Minimum lease payment (MLP) = "X". Fair value of the asset is "Y".*

(*Source: Question 10, Study Material*)

**Answer**

(i) If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, it is a Finance Lease.

(ii) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.

(iii) Since the asset is procured only for the use of lessee, it is a finance lease.

(iv) The lease is a finance lease if X = Y, or where X substantially equals Y.

## Question 9

*A machine was given on 3 years operating lease by a dealer of the machine for equal annual lease rentals to yield 30% profit margin on cost ₹1,50,000. Economic life of the machine is 5 years and output from the machine are estimated as 40,000 units, 50,000 units, 60,000 units, 80,000 units and 70,000 units consecutively for 5 years. Straight line depreciation in proportion of output is considered appropriate. Compute the following:*

*(i) Annual Lease Rent*

*(ii) Lease Rent income to be recognized in each operating year and*

*(iii) Depreciation for 3 years of lease.*

(*Source: Question 11, Study Material*)

**Answer**

**(i) Annual lease rent**

Total lease rent

$$= 130\% \text{ of } ₹1,50,000 \times \frac{\text{Output during lease period}}{\text{Total output}}$$

= 130% of ₹1,50,000 x (40,000 +50,000+ 60,000)/(40,000 + 50,000 + 60,000 + 80,000 + 70,000)

= 1,95,000 x 1,50,000 units/3,00,000 units = ₹97,500

Annual lease rent = ₹97,500 / 3 = ₹32,500

**(ii) Lease rent Income to be recognized in each operating year**

Total lease rent should be recognised as income in proportion of output during lease period, i.e. in the proportion of 40 : 50 : 60.

Hence income recognised in years 1, 2 and 3 will be as: Year 1 ₹26,000,
Year 2 ₹32,500 and

Year 3 ₹39,000.

**(iii) Depreciation for three years of lease**

Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹1,50,000 should be allocated over useful life 5 years in proportion of output, i.e. in proportion of 40 : 50 : 60 : 80 : 70 .

Depreciation for year 1 is ₹20,000, year 2 = 25,000 and year 3 = 30,000.

## Question 10

*Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being ₹7,00,000.*

*The economic life of machine as well as the lease term is 3 years. At the end of each year Lessee Ltd. pays ₹3,00,000. The Lessee has guaranteed a residual value of ₹22,000 on expiry of the lease to the Lessor. However, Lessor Ltd., estimates that the residual value of the machinery will be only ₹15,000. The implicit rate of return is 15% p.a. and present value factors at 15% are 0.869, 0.756 and 0.657 at the end of first, second and third years respectively.*

*Calculate the value of machinery to be considered by Lessee Ltd. and the finance charges in each year.*

(*Source: Question 12, Study Material*)

**Answer**

As per para 11 of AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

**Computation of Value of machinery:**

Present value of minimum lease payment = ₹6,99,054 (See working note below)

Fair value of leased asset = ₹7,00,000

Therefore, the recognition will be at the lower of the two i.e. 6,99,054

**Working Note - Present value of minimum lease payments:**

Annual lease rental × PVIF+ Present value of guaranteed residual value

= ₹3,00,000 × (0.869 + 0.756 + 0.657) + ₹22,000 × 0.657

= ₹6,84,600 + ₹14,454 = 6,99,054

**Computation of finance charges:**

| Year | Finance charge | Payment | Reduction in outstanding liability | Outstanding liability |
|---|---|---|---|---|
| 1st Year beginning | – | – | – | 6,99,054 |
| End of 1st year | 1,04,858 | 3,00,000 | 1,95,142 | 5,03,912 |
| End of 2nd year | 75,587 | 3,00,000 | 2,24,413 | 2,79,499 |
| End of 3rd year | 41,925 | 3,00,000 | 2,58,075 | 21,424 |

## Question 11

*B&P Ltd. availed a lease from N&L Ltd. The conditions of the lease terms are as under:*

(i) *Lease period is 3 years, in the beginning of the year 2009, for equipment costing ₹10,00,000 and has an expected useful life of 5 years.*

*(ii) The Fair market value is also ₹10,00,000*

*(iii) The property reverts back to the lessor on termination of the lease.*

*(iv) The unguaranteed residual value is estimated at ₹1,00,000 at the end of the year 2011.*

*(v) 3 equal annual payments are made at the end of each year.*

*(vi) Consider IRR = 10%.*

*The present value off ₹1 due at the end of 3rd year at 10% rate of interest is ₹0.7513. The present value of annuity of ₹1 due at the end of 3rd year at 10% IRR is ₹2.4868.*

*State whether the lease constitute finance lease and also calculate unearned finance income.*

(*Source: Question 13, Study Material*)

**Answer**

**Computation of annual lease payment:**

| Particulars | ₹ |
|---|---|
| Cost of equipment | 10,00,000 |
| Unguaranteed residual value | 1,00,000 |
| Present value of unguaranteed residual value | |
| (₹1,00,000 x 0.7513) | 75,130 |
| Present value of lease payments | |
| (₹10,00,000 - ₹75,130) | 9,24,870 |
| Present value of annuity for three years is 2.4868 | |
| Annual lease payment [9,24,870/2.4868] | 3,71,911.70 |

**Classification of lease:**

**Parameter 1:**

The present value of lease payment i.e., ₹9,24,870 which equals 92.48% of the fair market value i.e., ₹10,00,000.

The present value of minimum lease payments substantially covers the fair value of the leased asset

**Parameter 2:**

The lease term (i.e. 3 years) covers the major part of the life of asset (i.e. 5 years).

Therefore, it constitutes a finance lease.

**Computation of Unearned Finance Income:**

| Particulars | ₹ |
|---|---|
| Total lease payments (₹3,71,911.70 x 3) | 11,15,735 |
| Add: Unguaranteed residual value | 1,00,000 |
| Gross investment in the lease | 1,215,735 |
| Less: Present value of lease payments and residual value i.e. Net Investment (₹75,130 + ₹9,24,870) | (10,00,000) |
| **Unearned finance income** | **2,15,735** |

## Question 12

*X Ltd. sold machinery having WDV of ₹300 lakhs to Y Ltd. for ₹400 lakhs and the same machinery was leased back by Y Ltd. to X Ltd. The lease back arrangement is operating lease.*

*Give your comments in the following situations:*

*(i) Sale price of ₹400 lakhs is equal to fair value.*

*(ii) Fair value is ₹450 lakhs.*

*(iii) Fair value is ₹350 lakhs and the sale price is ₹250 lakhs.*

*(iv) Fair value is ₹300 lakhs and sale price is ₹400 lakhs.*

*(v) Fair value is ₹250 lakhs and sale price is ₹290 lakhs.*

(*Source: Question 14, Study Material*)

**Answer**

**Accounting Treatment:**

| S. No. | Particulars | Accounting Treatment |
|---|---|---|
| (i) | When sale price of ₹ 400 lakhs is equal to fair value | X Ltd. should immediately recognize the profit of ₹100 lakhs (i.e. 400 – 300) in its books. |
| (ii) | When fair value is ₹ 450 lakhs | Profit of ₹100 lakhs should be immediately recognized by X Ltd. |
| (iii) | When fair value of leased machinery is ₹350 lakhs & sales price is ₹250 lakhs | Then loss of ₹50 lakhs (300 – 250) to be immediately recognized by X Ltd. in its books provided loss is not compensated by future lease payment. |
| (iv) | When fair value is ₹300 lakhs & sales price is ₹400 lakhs | Then, profit of ₹100 lakhs is to be deferred and amortized over the lease period. |
| (v) | When fair value is ₹250 lakhs & sales price is ₹290 lakhs | Then the loss of ₹50 lakhs (300-250) to be immediately recognized by X Ltd. in its books and profit of ₹40 lakhs (290-250) should be amortized/ deferred over lease period. |

# QUESTION BANK

## Question 13

State any four situations when a lease would be classified as Finance Lease.

*(May, 2015, 4 Marks)*

**Answer**

Finance Lease is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership. As per AS 19, in following situations, the lease transactions would be classified as Finance lease:

(i) The lessee will get the ownership of leased asset at the end of the lease term.

(ii) The lessee has an option to buy the leased asset at the end of the lease term at price, which is lower than its expected fair value at the date on which option will be exercised.

(iii) The lease term covers the major part of the life of asset even if title is not transferred.

(iv) At the beginning of lease term, present value of minimum lease rental covers the initial fair value.

## Question 14

Aksat International Limited has given a machinery on lease for 36 months and its useful life is 60 months. Cost & fair market value of the machinery is ₹5,00,000. The amount will be paid in 3 equal annual installments and the lessee will return the machinery to lessor at termination of lease. The unguaranteed residual value at the end of 3 years is ₹50,000. IRR of investment is 10% and present value of annuity factor of ₹1 due at the end of 3 years at 10% IRR is 2.4868 and present value of ₹1 due at the end of 3rd year at 10% IRR is 0.7513.

You are required to comment with reason whether the lease constitute finance lease or operating lease. If it is finance lease, calculate unearned finance income.

(*November 2015, 5 Marks*)

**Answer:**

**Determination of Nature of Lease**

Present value of unguaranteed residual value at the end of 3rd year

= ₹50,000 x 0.7513

= ₹37,565

Present value of lease payments = ₹5,00,000 – ₹37,565

= ₹4,62,435

The percentage of present value of lease payments to fair value of the equipment is

(₹4,62,435/ ₹5,00,000) x 100 = 92.487%.

Since, lease payments substantially covers the major portion of the fair value; the lease constitutes a finance lease.

**Calculation of Unearned Finance Income**

| | | |
|---|---|---|
| Annual lease payment | = | ₹4,62,435/ 2.4868 =₹1,85,956 (approx.) |
| Gross investment in the lease | = | Total minimum lease payments + unguaranteed residual value |
| | = | (₹1,85,956 × 3) + ₹50,000 |
| | = | ₹5,57,868 + ₹50,000 = ₹6,07,868 |
| Unearned finance income | = | Gross investment - Present value of minimum lease payments and unguaranteed residual value |
| | = | ₹6,07,868 – ₹5,00,000 = ₹1,07,868 |

## Question 15

WIN Ltd. has entered into a three year lease arrangement with Tanya sports club in respect of Fitness Equipments costing ₹16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Values of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be ₹1,33,500. The assets would revert to the lessor at the end of the lease. Given that the implicit rate of interest is 10%.

You are required to calculate the amount of the annual lease payment and the unearned finance income. Discounting Factor at 10% for years 1, 2 and 3 are 0.909, 0.826 and 0.751 respectively.

(*RTP May 2018*)

**Answer:**

**(i) Computation of annual lease payment to the lessor**

| | ₹ |
|---|---:|
| Cost of equipment | 16,99,999.50 |
| Unguaranteed residual value | 1,33,500.00 |
| Present value of residual value after third year @ 10% (₹1,33,500 x 0.751) | 1,00,258.50 |

| | ₹ |
|---|---|
| Fair value to be recovered from lease payments (₹16,99,999.5 - ₹1,00,258.5) | 15,99,741.00 |
| Present value of annuity for three years is 2.486 | |
| Annual lease payment = ₹15,99,741/2.486 | 6,43,500.00 |

**(ii) Computation of Unearned Finance Income**

| | ₹ |
|---|---|
| Total lease payments (₹6,43,500 x 3) | 19,30,500 |
| Add: Unguaranteed residual value | 1,33,500 |
| Gross investment in the lease | 20,64,000.00 |
| Less: Present value of investment (lease payments and residual value) (₹1,00,258.5 + ₹15,99,741) | (16,99,999.50) |
| Unearned finance income | 3,64,000.50 |

## Question 16

ABC Ltd. took a machine on lease from XYZ Ltd., the fair value being ₹10,00,000. The economic life of the machine as well as the lease term is 4 years. At the end of each year, ABC Ltd. pays ₹3,50,000. The lessee has guaranteed a residual value of ₹50,000 on expiry of the lease to the lessor. However, XYZ Ltd. estimates that the salvage value of the machine will be only ₹35,000 only. It was not practicable for the lessee to determine the interest rate implicit in the lease, However the incremental borrowing rate of ABC Ltd. is determined at 16.4%. PV factors at 16.4% for year 1, year 2, year 3 and year 4 are 0.8591, 0.7381, 0.6341 and 0.5447 respectively. You are required to calculate the value of machinery to be considered by ABC Ltd. and the finance charges for each year.

(*MTP April 2018/2019; March 2019; October 2019 & RTP November 2018/May 2020*) (*5 Marks*)

**Answer:**

As per AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

**Value of machinery**

In the given case, fair value of the machinery is ₹10, 00,000 which is more than net present value of minimum lease payments of ₹9,98,835 (Refer working Note). Hence, the machine and the corresponding liability will be recorded at value of ₹9,98,835 in the books of ABC Ltd.

**Calculation of finance charges for each year**

| Year | Finance charge | Payment | Reduction in outstanding liability | Outstanding liability |
|---|---|---|---|---|
| 1st year beginning | - | - | - | 9,98,835 |
| End of 1st year | 1,63,809 | 3,50,000 | 1,86,191 | 8,12,644 |
| End of 2nd year | 1,33,274 | 3,50,000 | 2,16,726 | 5,95,918 |
| End of 3rd year | 97,731 | 3,50,000 | 2,52,269 | 3,43,649 |
| End of 4th year | 56,358 | 4,00,000* | 3,43,642 | 7** |

**Working Note:**

**Present value of minimum lease payments**

| | |
|---|---|
| Annual lease rental x PV factor<br>3,50,000 x (0.8591+ 0.7381+ 0.6341+ 0.5447) | ₹9,71,600 |
| Present value of guaranteed residual value<br>50,000 x (0.5447) | ₹27,235 |
| | ₹9,98,835 |

** includes guaranteed residual value of ₹50,000 (considered to be paid).*

*** it should be nil, difference of ₹7 due to approximations.*

## Question 17

Sun Limited wishes to obtain a machine costing ₹30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 5 years. It enters into an agreement with Star Ltd., for a lease rental for ₹3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Su n Limited is not sure about the treatment of these lease rentals and seeks your advise. You are required to explain the necessary accounting treatment in line with AS 19. (use annuity factor at @ 15% for 3 years as 3.36)

(*MTP August 2018*) (*5 Marks*)

**Answer:**

As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV - Annuity Factor can be computed as:

| | |
|---|---|
| Annuity Factor (Year 1 to Year 5) | 3.36 (approx.) |
| Present Value of minimum lease payments (₹3 lakhs each year) | ₹10.08 lakhs (approx.) |

Thus present value of minimum lease payments is ₹10.08 lakhs and the fair value of the machine is ₹30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for five years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

## Question 18

Jaya Ltd. took a machine on lease from Deluxe Ltd., the fair value being ₹11,50,000. Economic life of the machine as well as lease term is 4 years. At the end of each years, lessee pays ₹3,50,000 to lessor. Jaya Ltd. has guaranteed a residual value of ₹70,000 on expiry of the lease to Deluxe Ltd., however Deluxe Ltd. estimates that residual value will be only ₹25,000. The implicit rate of return is 10% p.a. and present value factors at 10% are: 0.909, 0.826, 0.751 and 0.683 at the end of 1st, 2nd, 3rd and 4th year respectively.

Calculate the value of machinery to be considered by Jaya Ltd. and the value of the lease liability as per AS-19.

(*May 2019*) (*5 Marks*)

**Answer:**

According to para 11 of AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of the finance lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee.

In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease. Present value of minimum lease payments will be calculated as follows:

| *Year* | *Minimum Lease Payment* ₹ | *Internal rate of return (Discount rate @10%)* | *Present value* ₹ |
|---|---:|---:|---:|
| 1 | 3,50,000 | 0.909 | 3,18,150 |
| 2 | 3,50,000 | 0.826 | 2,89,100 |
| 3 | 3,50,000 | 0.751 | 2,62,850 |
| 4 | 4,20,000 | 0.683 | 2,86,860 |
| Total | 14,70,000 | | 11,56,960 |

* *Minimum Lease Payment of 4th year includes guaranteed residual value amounting i.e. 3,50,000 + 70,000 = 4,20,000.*

Present value of minimum lease payments ₹11,56,960 is more than fair value at the inception of lease i.e. ₹11,50,000, therefore, the lease liability and machinery should be recognized in the books at ₹11,50,000 as per AS 19.

## Question 19

Sun Limited wishes to obtain a machine costing ₹30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 3 years. It enters into an agreement with Star Ltd., for a lease rental for ₹3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Suraj Limited is not sure about the treatment of these lease rentals and seeks your advice. (use annuity factor at @ 15% for 3 years as 3.36)

(*RTP November 2019*)

**Answer:**

As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment• amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

| | |
|---|---:|
| Annuity Factor (Year 1 to Year 3) | 3.36 |
| Present Value of minimum lease payments (₹3 lakhs each year) | ₹10.08 lakhs (approx.) |

Thus present value of minimum lease payments is ₹10.08 lakhs and the fair value of the machine is ₹30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for three years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

• In calculating the present value of the of minimum lease payments, the discount rate is the interest rate implicit in the lease.

## Question 20

Classify the following into either operating lease or finance lease with reason:

(1) Economic life of asset is 10 years, lease term is 9 years, but asset is not acquired at the end of lease term.

(2) Lessee has option to purchase the asset at lower than fair value at the end of lease term.

(3) Lease payments should be recognized as an expense in the statement of Profit & Loss of a lessee.

(4) Present Value (PV) of Minimum Lease Payment (MLP) = "X". Fair value of the asset is "Y". And X = Y.

(5) Economic life of the asset is 5 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee.

(*November 2019, New Course, 5 Marks*)

**Answer**

(i) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.

(ii) If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, it is a Finance Lease.

(iii) It is an operating lease under which lease payments are recognized as expense in the profit and loss account of lessee to have better matching between cost and revenue.

(iv) The lease is a finance lease if X = Y, or where X substantially equals Y.

(v) Since the asset is of special nature and has been procured only for the use of lessee, it is a finance lease.

## Question 21

(a) Classify the following into either operating or finance lease:

(i) Present value (PV) of Minimum lease payment (MLP) = "X". Fair value of the asset is "Y".

(ii) Economic life of the asset is 7 years, lease term is 6.5 years, but asset is not acquired at the end of the lease term;

(iii) Economic life of the asset is 6 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee .

(b) Viral Ltd. sold machinery having WDV of ₹40 lakhs to Saral Ltd. for ₹50 lakhs and the same machinery was leased back by Saral Ltd. to Viral Ltd. The lease back is in nature of operating lease. You are required to explain the treatment in the given cases –

(i) Fair value is ₹45 lakhs and sale price is ₹38 lakhs.

(ii) Fair value is ₹40 lakhs and sale price is ₹50 lakhs.

(iii) Fair value is ₹46 lakhs and sale price is ₹50 lakhs

(*RTP, November, 2020*)

**Answer**

**(a)** (i) The lease is a finance lease if X = Y, or if X substantially equals Y otherwise operating.

(ii) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.

(iii) Since the asset is procured only for the use of lessee, it is a finance lease.

**(b)** As per AS 19, where sale and leaseback results in operating lease, then the accounting treatment in different situations is as follows:

**Situation 1: Sale price = Fair Value**

Profit or loss should be recognized immediately.

**Situation 2: Sale Price < Fair Value**

Profit should be recognized immediately. The loss should also be recognized immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used.

**Situation 3: Sale Price > Fair Value**

The excess over fair value should be deferred and amortized over the period for which the asset is expected to be used.

Following will be the treatment in the situations given in the question:

(i) When fair value of leased machinery is ₹45 lakhs & sales price is ₹38 lakhs, then loss of ₹2 lakhs (40 – 38) to be immediately recognized by A Ltd. in its books provided loss is not compensated by future lease payment.

(ii) When fair value is ₹40 lakhs & sales price is ₹50 lakhs then, profit of ₹10 lakhs is to be deferred and amortized over the lease period.

(iii) When fair value is ₹46 lakhs & sales price is ₹50 lakhs, profit of ₹6 lakhs (46 less 40) to be immediately recognized in its books and balance profit of ₹4 lakhs (50-46) is to be amortized/deferred over lease period.

## Question 22

A machine was given on 3 years operating lease by a dealer of the machine for equal annual lease rentals to yield 30% profit margin on cost ₹1,50,000. Economic life of the machine is 5 years and output from the machine are estimated as 40,000 units, 50,000 units, 60,000 units, 80,000 units and 70,000 units consecutively for 5 years. Straight line depreciation in proportion of output is considered appropriate.

You are required to compute: (i) Annual Lease Rent and (ii) Lease Rent income to be recognized in each operating year.

(*MTP, March, 2021*) (*5 marks*)

**Answer**

**(i) Annual lease rent**

Total lease rent

$$= 130\% \text{ of Rs.} 1,50,000 \times \frac{\text{Output during lease period}}{\text{Total output}}$$

= 130% of ₹1,50,000 x (40,000 +50,000+ 60,000)/(40,000 + 50,000 + 60,000 + 80,000 + 70,000)

= 1,95,000 x 1,50,000 units/3,00,000 units = ₹97,500

Annual lease rent = ₹97,500 / 3 = ₹32,500

**(ii) Lease rent Income to be recognized in each operating year**

Total lease rent should be recognized as income in proportion of output during lease period, i.e. in the proportion of 40 : 50 : 60.

Hence income recognized in years 1, 2 and 3 will be as:

Year 1 ₹26,000,

Year 2 ₹32,500 and

Year 3 ₹39,000.

## Question 23

You are required to give the necessary journal entry at the inception of lease to record the asset taken on finance lease in books of lessee from the following information:

| | | |
|---|---|---|
| Lease period | = | 5 years; |
| Annual lease rents | = | ₹50,000 at the end of each year. |
| Guaranteed residual value | = | ₹25,000 |
| Fair Value at the inception (beginning) of lease | = | ₹2,00,000 |

Interest rate implicit on lease is = 12.6% (Discounted rates for year 1 to 5 are .890, .790, .700, .622 and .552 respectively).

(*MTP, April, 2021*) (*5 marks*)

**Answer**

**Present value of minimum lease payment is computed below:**

| Year | MLP ₹ | DF (12.6%) | PV ₹ |
|---|---|---|---|
| 1 | 50,000 | 0.890 | 44,500 |
| 2 | 50,000 | 0.790 | 39,500 |
| 3 | 50,000 | 0.700 | 35,000 |
| 4 | 50,000 | 0.622 | 31,100 |
| 5 | 50,000 | 0.552 | 27,600 |
| 5 | 25,000 | 0.552 | 13,800 |
| | | | 1,91,500 |

Present value of minimum lease payment = ₹1,91,500 Fair value of leased asset = ₹2,00,000

As per AS 19, on the date of inception of Lease, Lessee should show it as an asset and corresponding liability at lower of Fair value of leased asset at the inception of the lease and present value of minimum lease payments from the standpoint of the lessee. The accounting entry at the inception of lease to record the asset taken on finance lease in books of lessee is suggested below:

| | ₹ | ₹ |
|---|---|---|
| Asset A/c Dr. | 1,91,500 | |
| To Lessor (Lease Liability) A/c | | 1,91,500 |
| (Being recognition of finance lease as asset and liability) | | |

## Question 24

Sooraj Limited wishes to obtain a machine costing ₹30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 3 years. It enters into an agreement with Star Ltd., for a lease rental for ₹3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Sooraj Limited is not sure about the treatment of these lease rentals and seeks your advice. (use annuity factor at @ 15% for 3 years as 3.36)

(*RTP, May, 2021*)

**Answer**

As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment* amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

---

* *In calculating the present value of the of minimum lease payments, the discount rate is the interest rate implicit in the lease.*

| | |
|---|---|
| Annuity Factor (Year 1 to Year 3) | 3.36 |
| Present Value of minimum lease payments (₹3 lakhs each year) | ₹10.08 lakhs |

Thus present value of minimum lease payments is ₹10.08 lakhs and the fair value of the machine is ₹30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for three years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

## Question 25

X Ltd. sold machinery having WDV of ₹300 lakhs to Y Ltd. for ₹400 lakhs and the same machinery was leased back by Y Ltd. to X Ltd. The lease back arrangement is operating lease. Give your comments in the following situations:

(i) Sale price of ₹400 lakhs is equal to fair value.
(ii) Fair value is ₹450 lakhs.
(iii) Fair value is ₹350 lakhs and the sale price is ₹250 lakhs.
(iv) Fair value is ₹300 lakhs and sale price is ₹400 lakhs.
(v) Fair value is ₹250 lakhs and sale price is ₹290 lakhs.

(Suggested, January, 2021) (5 marks)

**Answer**

Following will be the treatment in the given cases:

(i) When sale price of ₹400 lakhs is equal to fair value, X Ltd. should immediately recognise the profit of ₹100 lakhs (i.e. 400 – 300) in its books.
(ii) When fair value is ₹450 lakhs then also profit of ₹100 lakhs should be immediately recognised by X Ltd.
(iii) When fair value of leased machinery is ₹350 lakhs & sales price is ₹250 lakhs, then loss of ₹50 lakhs (300 – 250) to be immediately recognised by X Ltd. in its books provided loss is not compensated by future lease payment.
(iv) When fair value is ₹300 lakhs & sales price is ₹400 lakhs then, profit of ₹100 lakhs is to be deferred and amortised over the lease period.
(v) When fair value is ₹250 lakhs & sales price is ₹290 lakhs, then the loss of ₹50 lakhs (300-250) to be immediately recognised by X Ltd. in its books and profit of ₹40 lakhs (290-250) should be amortised/deferred over lease period.

## Question 26

A machine was given on 3 years operating lease by a dealer of the machine for equal annual lease rentals to yield 30% profit margin on cost of ₹2, 25,000. Economic life of the machine is 5 years and output from the machine is estimated as 60,000 units, 75,000 units, 90,000 units, 1,20,000 units and 1,05,000 units consecutively for I years. Straight line depreciation in proportion of output is considered appropriate. You are required to compute the following as per AS-19.

(i) Annual Lease Rent
(ii) Lease Rent income to be recognised in each operating year and
(iii) Depreciation for 3 years of lease

(*Question Paper of December 2021*) *(5 Marks)*

**Answer**

**(i) Annual lease rent**

Total lease rent

= 130% of ₹2,25,000 × Output during lease period/ Total output

= 130% of ₹2,25,000 x (60,000 +75,000+ 90,000)/(60,000 + 75,000 + 90,000 + 1,20,000 + 1,05,000)

= 2,92,500 x 2,25,000 units/4,50,000 units = ₹1,46,250

Annual lease rent = ₹1,46,250 / 3 = ₹48,750

**(ii) Lease rent Income to be recognized in each operating year**

Total lease rent should be recognized as income in proportion of output during lease period, i.e. in the proportion of 60,000 : 75,000 : 90,000 or 4:5:6

Hence income recognized in years 1, 2 and 3 will be as:

Year 1 ₹39,000,

Year 2 ₹48,750 and

Year 3 ₹58,500.

**(iii) Depreciation for three years of lease**

Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹2,25,000 should be allocated over useful life 5 years in proportion of output, i.e. in proportion of 60 :75: 90 : 120 : 105 .

Depreciation for year 1 is ₹30,000, year 2 = 37,500 and year 3 = 45,000.

## Question 27

WIN Ltd. has entered into a three year lease arrangement with Tanya sports club in respect of Fitness Equipment's costing ₹ 16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Values of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be ₹ 1,33,500. The assets would revert to the lessor at the end of the lease. Given that the implicit rate of interest is 10%. You are required to compute the amount of the annual lease payment and the unearned finance income. Discounting Factor at 10% for years 1, 2 and 3 are 0.909, 0.826 and 0.751 respectively.

(*RTP November, 2022*)

**Answer**

**(i) Computation of annual lease payment to the lessor**

| | ₹ |
|---|---|
| Cost of equipment | 16,99,999.50 |
| Unguaranteed residual value | 1,33,500.00 |
| Present value of residual value after third year @ 10% (₹ 1,33,500 × 0.751) | 1,00,258.50 |
| Fair value to be recovered from lease payments (₹ 16,99,999.5– ₹ 1,00,258.5) | 15,99,741.00 |
| Present value of annuity for three years is 2.486 | |
| Annual lease payment = ₹ 15,99,741/ 2.486 | 6,43,500.00 |

**(ii) Computation of Unearned Finance Income**

| | ₹ |
|---|---|
| Total lease payments (₹ 6,43,500 x 3) | 19,30,500 |
| *Add:* Unguaranteed residual value | 1,33,500 |
| Gross investment in the lease | 20,64,000.00 |
| *Less:* Present value of investment (lease payments and residual value) (₹1,00,258.5+ ₹ 15,99,741) | (16,99,999.50) |
| Unearned finance income | 3,64,000.50 |

## Question 28

WIN Ltd. has entered into a three year lease arrangement with Tanya sports club in respect of Fitness Equipments costing ₹ 16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Values of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be ₹ 1,33,500. The assets would revert to the lessor at the end of the lease. Given that the implicit rate of interest is 10%.

You are required to calculate the amount of the annual lease payment and the unearned finance income. Discounting Factor at 10% for years 1, 2 and 3 are 0.909, 0.826 and 0.751 respectively.

(*RTP May, 2023*)

**Answer**

**(i) Computation of annual lease payment to the lessor**

| | ₹ |
|---|---|
| Cost of equipment | 16,99,999.50 |
| Unguaranteed residual value | 1,33,500.00 |
| Present value of residual value after third year @ 10% (₹ 1,33,500 × 0.751) | 1,00,258.50 |
| Fair value to be recovered from lease payments (₹ 16,99,999.5– ₹ 1,00,258.5) | 15,99,741.00 |
| Present value of annuity for three years is 2.486 | |
| Annual lease payment = ₹ 15,99,741/ 2.486 | 6,43,500.00 |

**(ii) Computation of Unearned Finance Income**

| | ₹ |
|---|---|
| Total lease payments (₹ 6,43,500 x 3) | 19,30,500 |
| *Add:* Unguaranteed residual value | 1,33,500 |
| Gross investment in the lease | 20,64,000.00 |
| *Less:* Present value of investment (lease payments and residual value) (₹ 1,00,258.5+ ₹ 15,99,741) | (16,99,999.50) |
| Unearned finance income | 3,64,000.50 |

CHAPTER **13**

# Accounting Standard 26 Intangible Assets

## Question 1

*ABC Ltd. developed know-how by incurring expenditure of ₹20 lakhs, The know-how was used by the company from 1.4.20X1. The useful life of the asset is 10 years from the year of commencement of its use. The company has not amortised the asset till 31.3.20X8. Pass Journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.20X8.*

**Answer**

**Journal Entry**

| | | ₹ | ₹ |
|---|---|---|---|
| Profit and Loss A/c (Prior period item) | Dr. | 12,00,000 | |
| Amortization A/c | Dr. | 2,00,000 | |
| To Know-how A/c* | | | 14,00,000 |
| [Being amortization of 7 years (out of which amortization of 6 years charged as prior period item)] | | | |

## Question 2

*The company had spent ₹45 lakhs for publicity and research expenses on one of its new consumer product, which was marketed in the accounting year 20X1 -20X2, but proved to be a failure. State, how you will deal with the following matters in the accounts of U Ltd. for the year ended 31st March, 20X2.*

**Answer**

In the given case, the company spent ₹45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/benefit because of the failure of the product. Thus, according to AS 26 'Intangible Assets', the company should charge the total amount of ₹45 lakhs as an expense in the profit and loss account.

## Question 3

*A company with a turnover of ₹250 crores and an annual advertising budget of ₹2 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹25 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of ₹2 crore incurred on extensive special initial advertisement campaign for the new product.*

*Is the procedure adopted by the company correct?*

**Answer**

According to AS 26 'Intangible Assets', "expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset".

AS 26 mentions that expenditure on advertising and promotional activities should be recognised as an expense when incurred.

In the given case, advertisement expenditure of ₹2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹25 crores.

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* As per para 63 of AS 26 "Intangible Assets", there is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.

Here, no intangible asset or other asset is acquired or created that can be recognised. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹2 crores to the Profit and Loss account of the year is correct.

## Question 4

*What is meant by Intangible Assets and what are the important factors to consider the recognition of item as an Intangible asset? What is the recognition criteria in accordance with the provisions of AS 26?*

**Answer**

An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Below are the 3 key ingredients to be satisfied to cover an item as an intangible asset under this standard:

- identifiability,
- control over a resource and
- expectation (i.e. probable – 50% plus) of future economic benefits flowing to the enterprise.

The recognition of an item as an intangible asset requires an enterprise to demonstrate that the item meets the definition of an intangible asset and recognition criteria set out as below:

a. It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
b. The cost of the asset can be measured reliably.

## Question 5

*What is the measurement criteria at the time of initial recognition of Intangible assets acquired through separate acquisition?*

**Answer**

If an intangible asset is acquired separately, the cost of the intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

The cost of an intangible asset comprises:

- its purchase price,
- any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), and
- any directly attributable expenditure on making the asset ready for its intended use. Directly attributable expenditure includes, for example, professional fees for legal services.
- Any trade discounts and rebates are deducted in arriving at the cost.

## Question 6

*What is the criteria for recognition and measurement of Internally generated intangible assets. Describe which kind of cost is considered for capitalisation with respect to provisions of AS 26. Whether the same applies for internally generated goodwill also?*

**Answer**

To assess whether an internally generated intangible asset meets the criteria for recognition, an enterprise classifies the generation of the asset into 2 phases:

- Research Phase &
- Development Phase

Research Phase - The expenses related to Research phase is expensed off in statement of Profit and loss.

Development Phase - Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the conditions given in para 6.15.

**<u>Cost of an Internally Generated Intangible Asset</u>**

The cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria. Reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports is prohibited.

The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and making the asset ready for its intended use from the time when the intangible asset first meets the recognition criteria. For details, refer para 6.16.

Internally generated goodwill is not recognised as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

## Question 7

*Advise the complete accounting treatment for Research and development phase as per AS 26.*

**Answer**

Research phase means acquisition of knowledge and Development phase means application of knowledge.

The expenditure related to Research phase is expensed off in statement of Profit and loss. However, the expenditure incurred in Development phase is capitalised as a cost of the internally generated intangible asset.

If an enterprise cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the enterprise treats the expenditure on that project as if it were incurred in the research phase only.

## Question 8

*What is meant by Amortisation of an Intangible asset. What are the different methods for amortisation as per AS 26?*

**Answer**

Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

The amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used. A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include

- the straight-line method,
- the diminishing balance method and
- the unit of production method.

The method used for an asset is selected based on the expected pattern of consumption of economic benefits and is consistently applied from period to period, unless there is a change in the expected pattern of consumption of economic benefits to be derived from that asset.

## Question 9

*Swift Ltd. acquired a patent at a cost of ₹80,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset at ₹10,00,000 per annum. The company had amortized the patent at 10,00,000 per annum in first two years on the basis of economic benefits derived from the product manufactured under the patent. After two years it was found that the product life-cycle may continue for another 5 years from then. The patent was renewable and Swift Ltd. got it renewed after expiry of five years. The net cash flows from the product during these 5 years were expected to be ₹36,00,000, ₹46,00,000, ₹44,00,000, ₹40,00,000 and ₹34,00,000. Find out the amortization cost of the patent for each of the years.*

**Answer**

Swift Limited amortised ₹10,00,000 per annum for the first two years i.e. ₹20,00,000. The remaining carrying cost can be amortised during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

| S | Net cash flows ₹ | Amortisation Ratio | Amortisation Amount ₹ |
|---|---|---|---|
| I | - | 0.125 | 10,00,000 |
| II | - | 0.125 | 10,00,000 |
| III | 36,00,000 | 0.180 | 10,80,000 |
| IV | 46,00,000 | 0.230 | 13,80,000 |
| V | 44,00,000 | 0.220 | 13,20,000 |
| VI | 40,00,000 | 0.200 | 12,00,000 |
| VII | 34,00,000 | 0.170 | 10,20,000 |
| Total | 2,00,00,000 | 1.000 | 80,00,000 |

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹60,00,000 has been amortised in the ratio of net cash flows arising from the product of Swift Ltd.

## Question 10

*AB Ltd. launched a project for producing product X in October, 20X1. The Company incurred ₹20 lakhs towards Research. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.*

*Advise the Company as per the applicable Accounting Standard.*

**Answer**

As per para 41 of AS 26 “Intangible Assets”, expenditure on research should be recognised as an expense when it is incurred. Hence, the expenses amounting ₹20 lakhs incurred on the research has to be charged to the statement of profit and loss in the current year ending 31st March, 20X2.

## Question 11

*During 20X1-X2, an enterprise incurred costs to develop and produce a routine low risk computer software product, as follows:*

| ***Particular*** | ***₹*** |
|---|---|
| *Completion of detailed program and design (Phase 1)* | *50,000* |
| *Coding and Testing (Phase 2)* | *40,000* |
| *Other coding costs (Phase 3 & 4)* | *63,000* |
| *Testing costs (Phase 3 & 4)* | *18,000* |
| *Product masters for training materials (Phase 5)* | *19,500* |
| *Packing the products (1,500 units) (Phase 6)* | *16,500* |

**Answer**

As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed program design, coding and testing. In this case, ₹90,000 would be recorded as an expense (₹50,000 for completion of detailed program design and ₹40,000 for coding and testing to establish technological feasibility/asset recognition criteria). Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (63,000+ 18,000+ 19,500) = ₹1,00,500. Packing cost ₹16,500 should be recognized as expenses and charged to P & L A/c.

# QUESTION BANK

## Question 12

A company acquired a patent at a cost of ₹160 lakhs for a period of 5 years and the product life cycle is also 5 years. The company capitalized the cost and started amortising the asset at ₹16 lakhs per year based on the economic benefits derived from the product manufactured under the patent. After 2 years it was found that the product life cycle may continue for another 5 years from then (the patent is renewable and the company can get it renewed after 5 years). The net cash flows from the product during these 5 years were expected to be ₹50 lakhs, ₹30 lakhs, ₹60 lakhs, ₹70 lakhs and ₹40 lakhs. Find out the amortization cost of the patent for each of the years.

*(May 2018) (5 Marks)*

**Answer:**

Company amortized ₹16,00,000 per annum for the first two years. Hence, Amortization for the first two years (₹16,00,000 x 2) = ₹32,00,000.

Remaining carrying cost after two years = ₹1,60,00,000 - ₹32,00,000
= ₹1,28,00,000

Since after two years it was found that the product life cycle may continue for another 5 years, hence the remaining carrying cost ₹128 lakhs will be amortized during next 5 years in the ratio of net cash arising from the sale of the products of Fast Limited.

The amortization cost of the patents may be computed as follows:

| Year | Net cash flows | Amortization Ratio | Amortization Amount ₹ |
|---|---|---|---|
| I | - | 0.1 | 16,00,000 |
| II | - | 0.1 | 16,00,000 |
| III | 50,00,000 | 0.2 | 25,60,000 |
| IV | 30,00,000 | 0.12 | 15,36,000 |
| V | 60,00,000 | 0.24 | 30,72,000 |
| VI | 70,00,000 | 0.28 | 35,84,000 |
| VII | 40,00,000 | 0.16 | 20,48,000 |
| Total | 250,00,000 | 1.000 | 160,00,000 |

## Question 13

K Ltd. launched a project for producing product X in October, 2016. The Company incurred ₹40 lakhs towards Research and Development expenses upto 31st March, 2017. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.

You are required to advise the Company as per the applicable Accounting Standard.

(*RTP May 2018*)

**Answer:**

As per provisions of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognized when no future economic benefits are expected from its use according to para 87 of the standard. Thus, the manager cannot defer the expenditure write off to future years in the given case. Hence, the expenses amounting ₹40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2017.

## Question 14

A Ltd. has got the license to manufacture particular medicines for 10 years at a license fee of ₹200 lakhs. Given below is the pattern of expected production and expected operating cash inflow:

| Year | Production in bottles (in lakhs) | Net operating cash flow (₹ in lakhs) |
|---|---|---|
| 1 | 300 | 900 |
| 2 | 600 | 1,800 |
| 3 | 650 | 2,300 |
| 4 | 800 | 3,200 |
| 5 | 800 | 3,200 |
| 6 | 800 | 3,200 |
| 7 | 800 | 3,200 |
| 8 | 800 | 3,200 |
| 9 | 800 | 3,200 |
| 10 | 800 | 3,200 |

Net operating cash flow has increased for third year because of better inventory management and handling method.

You are required to determine the amortization method in line with AS 26.

(*MTP April 2018/2019 & October 2019*) (*5 Marks*)

**Answer:**

As per AS 26 'Intangibles Assets', the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used.

In the instant case, the pattern of economic benefit in the form of net operating cash flow vis-a-vis production is determined reliably. A Ltd. should amortize the license fee of ₹200 lakhs as under:

| Year | Net operating Cash inflow (₹) | Ratio | Amortize amount (₹ in lakhs) |
|---|---|---|---|
| 1 | 900 | 0.03 | 6 |
| 2 | 1,800 | 0.06 | 12 |
| 3 | 2,300 | 0.08 | 16 |
| 4 | 3,200 | 0.12 | 24 |
| 5 | 3,200 | 0.12 | 24 |
| 6 | 3,200 | 0.12 | 24 |
| 7 | 3,200 | 0.12 | 24 |
| 8 | 3,200 | 0.12 | 24 |
| 9 | 3,200 | 0.12 | 24 |
| 10 | 3,200 | 0.11 (bal.) | 22 |
| | 27,400 | 1.00 | 200 |

## Question 15

Desire Ltd. acquired a patent at a cost of ₹1,00,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset on SLM. After two years it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be ₹45,00,000, ₹42,00,000, ₹40,00,000, ₹38,00,000 and ₹35,00,000. Patent is renewable and company changed amortization method from 3rd year (i.e. from SLM to ratio of expected new cash flows).

You are required to compute the amortization cost of the patent for each of the years (1st year to 7th year).

(*RTP November 2018*)

**Answer*:***

Desire Limited amortised ₹20,00,000 per annum for the first two years i.e. ₹40,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

| Year | Net cash flows ₹ | Amortization Ratio | Amortization Amount ₹ |
|---|---|---|---|
| I | - | 0.200 | 20,00,000 |
| II | - | 0.200 | 20,00,000 |
| III | 45,00,000 | 0.225 | 13,50,000 |
| IV | 42,00,000 | 0.21 | 12,60,000 |
| V | 40,00,000 | 0.20 | 12,00,000 |
| VI | 38,00,000 | 0.19 | 11,40,000 |
| VII | 35,00,000 | 0.175 | 10,50,000 |
| Total | 2,00,00,000 | 1.000 | 1,00,00,000 |

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹60,00,000 has been amortized in the ratio of net cash flows arising from the product of Desire Ltd.

## Question 16

A Company with a turnover of ₹375 crores and an annual advertising budget of ₹3 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹37.5 croes from the new product. The company had debited to its

Profit and Loss account the total expenditure of ₹3 crores incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the Company correct?

(*RTP May, 2019*)

**Answer*:***

According to AS 26 'Intangible Assets', "expenditure on an intangible item should be recognized as an expense when it is incurred unless it forms part of the cost of an intangible asset'.

In the given case, advertisement expenditure of ₹3 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹37.5 crores. Here, no intangible asset or another asset is acquired or created that can be recognized.

Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹3 crores to the Profit and Loss account of the year is correct.

## Question 17

K Ltd. launched a project for producing product X in October, 2016. The Company incurred ₹40 lakhs towards Research and Development expenses upto 31st March, 2018. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years. Advise the Company as per the applicable Accounting Standard.

*(MTP-March 2019/ RTP November 2019) (5 Marks)*

**Answer:**

As per provisions of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognized when no future economic benefits are expected from its use according to para 87 of the standard. Thus, the manager cannot defer the expenditure write off to future years in the given case. Hence, the expenses amounting ₹40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2018.

## Question 18

As per provision of AS-26, how would you deal to the following situations:

(1) ₹23,00,000 paid by a manufacturing company to the legal advisor defending the patent of a product is treated as a capital expenditure.

(2) During the year 2018-19, a company spent ₹7,00,000 for publicity and research expenses on one of its new consumer product which was marketed in the same accounting year but proved to be a failure.

(3) A company spent ₹25,00,000 in the past three years to develop a product, these expenses were charged to profit and loss account since they did not meet AS-26 criteria for capitalization. In the current year approval of the concerned authority has been received. The company wishes to capitalize ₹25,00,000 by disclosing it as a prior period item.

(4) A company with a turnover of ₹200 crores and an annual advertising budget of ₹50,00,000 had taken up for the marketing of a new product by a company. It was estimated that the company would have a turnover of ₹20 crore from the new product. The company had debited to its Profit & Loss Account the total expenditure of ₹50,00,000 incurred on extensive special initial advertisement campaign for the new product.

(*November 2019, 5 Marks*)

**Answer**

As per AS 26 “Intangible Assets”, subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense when it is incurred unless (a) it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and (b) expenditure can be measured and attributed to the asset reliably. If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

(i) In the given case, the legal expenses to defend the patent of a product amounting ₹23,00,000 should not be capitalized and be charged to Profit and Loss Statement.

(ii) The company is required to expense the entire amount of ₹7,00,000 in the Profit and Loss account for the year ended 31 st March, 2019 because no benefit will arise in the future.

(iii) As per AS 26, expenditure on an intangible item that was initially recognized as an expense by a reporting enterprise in previous annual financial statements should not be recognized as part of the cost of an intangible asset at a later date. Thus the company cannot capitalize the amount of ₹25,00,000 and it should be recognized as expense

(iv) Expenditure of ₹50,00,000 on advertising and promotional activities should always be charged to Profit and Loss Statement. Hence, the company has done the corre ct treatment by debiting the sum of 50 lakhs to Profit and Loss Account.

## Question 19

A company acquired patent right for ₹1200 lakhs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of estimated future cash flows which are as under:

| Year | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Estimated future cash flows<br>(₹ in lakhs) | 600 | 600 | 600 | 300 | 300 |

After 3rd year, it was ascertained that the patent would have an estimated balance future life of 3 years and the estimated cash flow after 5th year is expected to be ₹150 lakhs. You are required to determine the amortization pattern under Accounting Standard 26.

(*May 2020*)

**Answer**

**Amortization of cost of patent as per AS 26**

| *Year* | *Estimated future cash flow (₹ in lakhs)* | *Amortization Ratio* | *Amortized Amount (₹ in lakhs)* |
|---|---|---|---|
| 1 | 600 | .25 | 300 |
| 2 | 600 | .25 | 300 |
| 3 | 600 | .25 | 300 |
| 4 | 300 | .40 (Revised) | 120 |
| 5 | 300 | .40 (Revised) | 120 |
| 6 | 150 | .20 (Revised) | 60 |
| | | | 1,200 |

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (600: 600: 600: 300: 300).

The unamortized amount of the patent after third year will be ₹300 lakh (1,200-900) which will be amortized in the ratio of revised estimated future cash flows (300:300:150) in the fourth, fifth and sixth year.

## Question 20

Sudesh Ltd. acquired a patent at a cost of ₹2,40,00,000 for a period of 5 years and the product life-cycle was also 5 years. The company capitalized the cost and started amortizing the asset at ₹48,00,000 per annum. After two years it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be ₹36,00,000, ₹46,00,000, ₹44,00,000, ₹40,00,000 and ₹34,00,000. Find out the amortization cost of the patent for each of the years if the patent was renewable and Sudesh Ltd. got it renewed after expiry of five years.

(*MTP, October, 2020*) (*5 marks*)

**Answer**

The entity amortised ₹48,00,000 per annum for the first two years i.e. ₹96,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

| **Year** | **Net cash flows ₹** | **Amortization Ratio** | **Amortization Amount ₹** |
|---|---|---|---|
| I | - | 0.20 | 48,00,000 |
| II | - | 0.20 | 48,00,000 |
| III | 36,00,000 | 0.180 | 25,92,000 |
| IV | 46,00,000 | 0.230 | 33,12,000 |
| V | 44,00,000 | 0.220 | 31,68,000 |
| VI | 40,00,000 | 0.200 | 28,80,000 |
| VII | 34,00,000 | 0.170 | 24,48,000 |
| Total | 2,00,00,000 | 1.000 | 2,40,00,000 |

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹1,44,00,000 has been amortized in the ratio of net cash flows arising from the product of Change Ltd.

## Question 21

X Ltd. carried on business of manufacturing of Bakery products. The company has two trademarks "Sun" and "Surya". One month before the company knows through one of the marketing managers that both trademarks have allegedly been infringed by other competitors engaged in the same field. After investigation, legal department of the company informed that it had weak case on trademark “Sun” and strong case in regard to trademark “Surya”'. X Ltd. incurred additional legal fees to stop infringement on both trademarks. Both trademarks have a remaining legal life of 10 years. How should X Ltd. account for these legal costs incurred relating to the two trademarks?

(*RTP, November, 2020*)

**Answer**

As per AS 26, subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense. However, if the subsequent expenditure enables the asset to generate future economic benefits in excess of its originally assessed standard of performance or can be measured and attributed to the asset reliably, then such subsequent expenditure should be added to the cost of the intangible asset.

The legal costs incurred for both the trademarks do not enable them to generate future economic benefits in excess of its originally assessed standard of performance. They only ensure to maintain them if the case is decided in favour of the company. Therefore, such legal costs incurred for both trademarks must be recognized as an expense.

## Question 22

RC Ltd. is showing an intangible asset at ₹72 lakhs as on 31 -3-2020. This asset was acquired for ₹120 lakhs as on 01-04-2014 and the same was used from that date. The company has been following the policy of amortization of the intangible assets over a period of 15 years, on straight line basis.

You are required to comment on the accounting treatment of asset with reference to AS 26 "Intangible Assets" and also give the necessary rectification journal entry in the books.

(*MTP, March, 2021*) (*5 marks*)

**Answer**

As per AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. The Company has been following the policy of amortization of the intangible asset over a period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS 26.

Accordingly, the company would be required to restate the carrying amount of intangible asset as on 31.3.2020 at ₹48 lakhs i.e. ₹120 lakhs less ₹72 lakhs (₹120 Lakhs / 10 years x 6 years = 72 Lakhs). The difference of ₹24 Lakhs (₹72 lakhs – ₹48 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹48 lakhs will be amortized over remaining 4 years by amortizing ₹12 lakhs per year**.**

The necessary journal entry (for rectification) will be

| | | |
|---|---|---|
| Revenue Reserves | Dr. ₹24 Lakhs | |
| To Intangible Assets | | ₹24 Lakhs |

(Adjustment to reserves due to restatement of the carrying amount of intangible asset)

## Question 23

Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred ₹10 lakh on research during first 5 months of the financial year 2020-21. The development of the process began on 1st September, 2020 and upto 31st March, 2021, a sum of ₹8 lakh was incurred as Development Phase Expenditure, which meets assets recognition criteria. From 1st April, 2021, the Company has implemented the new process design and it is likely that this will result in after tax saving of ₹2 lakh per annum for next five years. The cost of capital is 10%. The present value of annuity factor of ₹1 for 5 years @ 10% is 3.7908.

Decide the treatment of Research and Development Cost of the project as per AS 26.

(*MTP, April, 2021*) (*5 marks*)

**Answer**

Research Expenditure – According to AS 26 'Intangible Assets', the expenditure on research of new process design for its product ₹10 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. It is presumed that the entire expenditure is incurred in the financial year 2020-21. Hence, it should be written off as an expense in that year itself.

*Cost of internally generated intangible asset* – it is given that development phase expenditure amounting ₹8 lakhs incurred upto 31st March, 2021 meets asset recognition criteria. As per AS 26, for measurement of such internally generated intangible asset, fair value should be estimated by discounting estimated future net cash flows.

| | |
|---|---|
| Savings (after tax) from implementation of new design for next 5 years | ₹2 lakhs p.a. |
| Company's cost of capital | 10 % |
| Annuity factor @ 10% for 5 years | 3.7908 |
| Present value of net cash flows (₹2 lakhs x 3.7908) | ₹7.582 lakhs |

The cost of an internally generated intangible asset would be lower of cost value ₹8 lakhs or present value of future net cash flows ₹7.582 lakhs.

Hence, cost of an internally generated intangible asset will be ₹7.582 lakhs.

The difference of ₹0.418 lakhs (i.e. ₹8 lakhs – ₹7.582 lakhs) will be amortized by Plymouth for the financial year 2020-21.

Amortisation - The company can amortise ₹7.582 lakhs over a period of five years by charging ₹1.516 lakhs per annum from the financial year 2021-2022 onwards.

## Question 24

Swift Limited acquired patent rights to manufacture Solar Roof Top Panels at a cost of ₹600 lacs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of future cash flows which are estimated as under:

| Year | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Cash Flows (₹ in lacs) | 300 | 300 | 300 | 150 | 150 |

After 3rd year, it was estimated that the patents would have an estimated balance future life of 3 years and Swift Ltd. expected the estimated cash flow after 5th year to be ₹75 Lacs. Determine the amortization cost of the patent for each of the above years as per Accounting Standard 26.

(*Suggested, November, 2020*)

**Answer**

**Amortization of cost of patent as per AS 26**

| Year | Estimated future cash flow (₹ in lakhs) | Amortization Ratio | Amortized Amount (₹ in lakhs) |
|---|---|---|---|
| 1 | 300 | .25 | 150 |
| 2 | 300 | .25 | 150 |

| Year | Estimated future cash flow (₹ in lakhs) | Amortization Ratio | Amortized Amount (₹ in lakhs) |
|---|---|---|---|
| 3 | 300 | .25 | 150 |
| 4 | 150 | .10 | 60 |
| 5 | 150 | .10 | 60 |
| 6 | 75 | .05 | 30 |
| | | 1.00 | 600 |

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (300: 300: 300: 150: 150).The unamortized amount of the patent after third year will be ₹150 lakh (600-450) which will be amortized in the ratio of revised estimated future cash flows (150:150:75 or 2:2:1) in the fourth, fifth and sixth year.

## Question 25

M/s. Pasa Ltd. is developing a new production process. During the financial year ended 31st March, 2019, the total expenditure incurred on the process was ₹80 lakhs. The production process met the criteria for recognition as an intangible asset on 1st November, 2018. Expenditure incurred till this date was ₹42 lakhs.

Further expenditure incurred on the process for the financial year ending 31st March, 2020 was ₹90 lakhs. As on 31.03.2020, the recoverable amount of know how embodied in the process is estimated to be ₹82 lakhs. This includes estimates of future cash outflows and inflows.

You are required to work out:

(1) What is the expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2019 ?

(2) What is the carrying amount of the intangible asset as on 31st March, 2019?

(3) What amount of expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2020 ?

What is the carrying amount of the intangible asset as on 31st March, 2020?

(*Suggested, November, 2020*) (*5 marks*)

**Answer**

As per AS 26 'Intangible Assets'

**(i) Expenditure to be charged to Profit and Loss account for the year ending 31.03.2019**

₹42 lakhs is recognized as an expense because the recognition criteria were not met until 1st November, 2018. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the balance sheet.

**(ii) Carrying value of intangible asset as on 31.03.2019**

At the end of financial year, on 31st March 2019, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹38 (80-42) lakhs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st November 2018)

**(iii) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2020**

| | **(*₹ in lacs*)** |
|---|---|
| Carrying Amount as on 31.03.2019 | 38 |
| Expenditure during 2019 – 2020 | 90 |
| Book Value | 128 |
| Recoverable Amount | (82) |
| Impairment loss to be charged to Profit and loss account | 46 |

₹46 lakhs to be charged to Profit and loss account for the year ending 31.03.2020.

**(iv) Carrying value of intangible asset as on 31.03.2020**

| | **(*₹ in lacs*)** |
|---|---|
| Book Value | 128 |
| *Less:* Impairment loss | (46) |
| Carrying amount as on 31.03.2020 | 82 |

## Question 26

A Company acquired for its internal use a software on 01.03.2020 from U.K. for £ 1,50,000. The exchange rate on the date was as ₹100 per £. The seller allowed trade discount @ 2.5%. The other expenditures were:

(i) Import Duty 10%

(ii) Additional Import Duty 5%

(iii) Entry Tax 2% (Recoverable later from tax department).

(iv) Installation expenses ₹1,50,000.

(v) Professional fees for clearance from customs ₹50,000.

Compute the cost of software to be Capitalized as per relevant AS.

(*Suggested, January, 2021*) (*5 marks*)

**Answer**

**Calculation of cost of software (intangible asset) acquired for internal use**

| | |
|---|---|
| Purchase cost of the software | £ 1,50,000 |
| *Less*: Trade discount @ 2.5% | £ ( 3,750) |
| | £1,46,250 |
| Cost in ₹(UK £1,46,250 x ₹100) | 146,25,000 |
| *Add*: Import duty on cost @ 10% (₹) | 14,62,500 |
| | 160,87,500 |
| Add: Additional import duty @ 5% (₹) | 8,04,375 |
| | 168,91,875 |
| Add: Installation expenses (₹) | 1,50,000 |
| Add: Professional fee for clearance from customs (₹) | 50,000 |
| Cost of the software to be capitalized (₹) | 170,91,875 |

Note: Since entry tax has been mentioned as a recoverable/refundable tax, it is not included as part of the cost of the asset.

## Question 27

During 2020-21, an enterprise incurred costs to develop and produce a routine low risk computer software product, as follows:

| Particular | ₹ |
|---|---|
| Completion of detailed program and design (Phase 1) | 50,000 |
| Coding and Testing (Phase 2) | 40,000 |
| Other coding costs (Phase 3 & 4) | 63,000 |
| Testing costs (Phase 3 & 4) | 18,000 |
| Product masters for training materials (Phase 5) | 19,500 |
| Packing the products (1,500 units) (Phase 6) | 16,500 |

After completion of phase 2, it was established that the product is technically feasible for the market. You are required to state how the above cost to be recognized in the books of accounts as per AS 26.

(*MTP*, *October 2021*) (*5 Marks*)

**Answer**

As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed program design or working model.

In this case, ₹90,000 would be recorded as an expense (₹50,000 for completion of detailed program design and ₹40,000 for coding and testing to establish technological feasibility/asset recognition criteria).

Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (63,000+ 18,000+ 19,500) = ₹1,00,500. Packing cost ₹16,500 should be recognized as expenses and charged to P & L A/c.

## Question 28

A company is showing an intangible asset at ₹88 lakhs as on 01.04.2021. This asset was acquired for ₹120 lakhs on 01.04.2017 and the same was available for use from that date. The company has been following the policy of amortization of the intangible assets over a period of 15 years on straight line basis. Comment on the accounting treatment of the above with reference to the relevant Accounting Standard.

(*RTP November 2021*)

**Answer**

As per AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Company has been following the policy of amortization of the intangible asset over a period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS 26. Accordingly, the company would be required to restate the carrying amount of intangible asset as on 01.04.2021 at ₹72 lakhs i.e. ₹120 lakhs less ₹48 lakhs

$$\left(\frac{₹120\text{ Lakhs}}{10\text{ years}} \times ₹4\text{ years} = 48\text{ Lakhs}\right)$$

The difference of ₹16 Lakhs (₹88 lakhs – ₹72 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹72 lakhs will be amortized over remaining 6 years by amortizing ₹12 lakhs per year.

## Question 29

(a) PQR Ltd. has acquired a Brand from another company for ₹100 lakhs. PQR Ltd. contends that since the said brand is a very popular and famous brand, no amortization needs to be provided. Comment on this in line with the Accounting Standards.

(b) X Ltd. is engaged in the business of newspaper and radio broadcasting. It operates through different brand names. During the year ended 31st March, 2021, it incurred substantial amount on business communication and branding expenses by participation in various corporate social responsibility initiatives. The company expects to benefit by this expenditure by attracting new customers over a period of time and accordingly it has capitalized the same under brand development expenses and intends to amortize the same over the period in which it expects the benefits to flow. As the accountant of the company do you concur with these views? You are required to explain in line with provisions of Accounting Standards.

(*RTP May, 2022*)

**Answer**

**(a)** AS 26 'Intangible Assets" provides that an intangible asset should be measured initially at cost. After initial recognition, an intangible asset should be carried at cost less any accumulated amortization and any accumulated impairment losses. The amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life for computing amortization. There is a rebuttable presumption that the useful life of an intangible asset will not exceed 10 years from the date when the asset is available for use. It must be ensured that the value of brand is amortized in accordance with AS 26, as brand is considered to be intangible asset. The contention of PQR Ltd. that Brand is very popular and famous, hence no amortization needs to be provided is not correct as there is no persuasive evidence that the useful life of the intangible asset will exceed 10 years.

**(b)** As per AS 26 on Intangible Assets, expenditure on an intangible item should be recognized as on expense when it is incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria. An intangible asset should be recognized if, and only if: (i) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and (ii) the cost of the asset can be measured reliably. In the given case, no intangible assets or other asset is acquired or created that can be recognized, the accounting treatment by the company to amortize the entire expenditure over the period in which it expects the benefits to flow is not correct and the same should be debited to the profit and loss statement during the year ended 31st March, 2021.

## Question 30

Surgical Ltd. is developing a new production process. of surgical equipment. During the financial year ended 31st March, 2020 the total expenditure incurred on the process was ₹67 lakhs. The production process met the criteria. for recognition as an intangible assets on 1st January, 2020. Expenditure incurred till this date was ₹35 lakhs.

Further expenditure incurred on the process for the financial year ending 31st March, 2021 was ₹105 lakhs. As on 31st March, 2021, the recoverable amount of technique embodied in the process is estimated to be ₹89 lakhs. This includes estimates of future cash outflows and inflows.

Under the provisions of AS 26, you are required to ascertain:

(i) The expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2020;

(ii) Carrying amount of the intangible asset as on 31st March, 2020;

(iii) Expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2021;

(iv) Carrying amount of the intangible asset as on 31st March, 2021.

(*Question Paper of December 2021*) *(5 Marks)*

**Answer:**

**As per AS 26 'Intangible Assets'**

**(i) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2020**

₹35 lakhs is recognized as an expense because the recognition criteria were not met until 1stJanuary 2020. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the balance sheet.

**(ii) Carrying value of intangible asset as on 31.03.2020**

At the end of financial year, on 31st March 2020, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹32 (67-35) lacs (expenditure incurred since the date the recognition criteria were met, i.e., from 1stJanuary 2020).

**(iii) Expenditure to be charged to Profit and Loss account for the year ended 31.03.2021**

| | ***(₹ in lacs)*** |
|---|---:|
| Carrying Amount as on 31.03.2020 | 32 |
| Expenditure during 2020 – 2021 | 105 |
| Book Value | 137 |
| Recoverable Amount | (89) |
| Impairment loss | 48 |

₹48 lakhs to be charged to Profit and loss account for the year ending 31.03.2021.

**(iv) Carrying value of intangible asset as on 31.03.2021**

| | *(₹ in lacs)* |
|---|---:|
| Book Value | 137 |
| *Less:* Impairment loss | (48) |
| Carrying amount as on 31.03.2021 | 89 |

## Question 31

M/s. Mahesh Ltd. is developing a new production process. During the Financial Year ended 31st March, 2013, the total expenditure incurred on the process was ₹60 lacs. The production process met the criteria for recognition as an intangible asset on 1st December, 2012. Expenditure incurred till this date was ₹32 lacs.

Further expenditure incurred on the process for the Financial Year ending 31st March, 2014 was ₹90 lacs. As on 31.03.2014, the recoverable amount of know-how embodied in the process is estimated to be ₹82 lacs. This includes estimates of future cash outflows and inflows.

You are required to work out:

(i) What is the expenditure to be charged to Profit & Loss Account for the year ended 31st March, 2013?

(ii) What is the carrying amount of the intangible asset as on 31st March, 2013?

(iii) What is the expenditure to be charged to Profit & Loss Account for the year ended 31st March, 2014?

(iv) What is the carrying amount of the intangible asset as on 31st March, 2014?

(*May, 2015, 5 Marks*)

**Answer**

**As per AS 26 'Intangible Assets'**

(i) **Expenditure to be charged to Profit and Loss account for the year ending 31.03.2013**

₹32 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2012. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the balance sheet.

(ii) **Carrying value of intangible asset as on 31.03.2013**

At the end of financial year, on 31st March 2013, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹28 (60-32) lacs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st December 2012).

(iii) **Expenditure to be charged to Profit and Loss account for the year ended 31.03.2014**

| | *(₹ in lacs)* |
|---|---:|
| Carrying Amount as on 31.03.2013 | 28 |
| Expenditure during 2013-2014 | 90 |
| Book Value | 118 |
| Recoverable Amount | (82) |
| Impairment loss | 36 |

₹36 lakhs to be charged to Profit and loss account for the year ending 31.03.2014.

(iv) **Carrying value of intangible asset as on 31.03.2014**

| | *(₹ in lacs)* |
|---|---:|
| Book Value | 118 |
| Less: Impairment loss | (36) |
| Carrying amount as on 31.03.2014 | 82 |

## Question 32

A Company with a turnover of ₹375 crores and an annual advertising budget of ₹3 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹37.5 crores from the new product. The Company had debited to its Profit and Loss account and total expenditure of ₹3 crores incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the Company correct? (*November, 2016, 5 Marks*)

**Answer**

According to AS 26 'Intangible Assets', "expenditure on an intangible item should be recognized as an expense when it is incurred unless it forms part of the cost of an intangible asset".

In the given case, advertisement expenditure of ₹3 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹37.5 crores. Here, no intangible asset or another asset is acquired or created that can be recognized.

Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹3 crores to the Profit and Loss account of the year is correct.

## Question 33

K Ltd. launched a project for producing product X in October, 2021. The Company incurred ₹ 40 lakhs towards Research and Development expenses upto 31st March, 2022. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.

Advise the Company as per the applicable Accounting Standard.

(*RTP November, 2022*)

**Answer**

As per AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to the standard. Thus, the manager cannot defer the expenditure write off to future years in the given case.

Hence, the expenses amounting ₹ 40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2022.

CHAPTER 14

# Accounting Standard 28 Impairment of Assets

**Question 1**

*Ergo Industries Ltd. gives the following estimates of cash flows relating to Property, Plant and Equipment on 31-12-20X1. The discount rate is 15%.*

| *Year* | *Cash Flow (₹ in lakhs)* | |
|---|---|---|
| *20X2* | *4000* | |
| *20X3* | *6000* | |
| *20X4* | *6000* | |
| *20X5* | *8000* | |
| *20X6* | *4000* | |
| *Residual value at the end of 20X6* | = | *₹1000 lakhs* |
| *Property, Plant and Equipment purchased on 1-1-20XX* | = | *₹40,000 lakhs* |
| *Useful life* | = | *8 years* |
| *Net selling price on 31-12-20X1* | = | *₹20,000 lakhs* |
| *Calculate on 31-12-20X1:* | | |

*(a) Carrying amount at the end of 20X1*
*(b) Value in use on 31-12-20X1*
*(c) Recoverable amount on 31-12-20X1*
*(d) Impairment loss to be recognized for the year ended 31-12-20X1*
*(e) Revised carrying amount*
*(f) Depreciation charge for 20X2.*

***Note:*** *The year 20XX is the immediate preceding year before the year 20X0.*

**Answer**

**Calculation of value in use**

| *Year* | *Cash Flow* | *Discount as per 15%* | *Discounted cash flow* |
|---|---|---|---|
| 20X2 | 4,000 | 0.870 | 3,480 |
| 20X3 | 6,000 | 0.756 | 4,536 |
| 20X4 | 6,000 | 0.658 | 3,948 |
| 20X5 | 8,000 | 0.572 | 4,576 |
| 20X6 | 4,000 | 0.497 | 1,988 |
| 20X6 | (residual) 1,000 | 0.497 | 497 |
| | | | 19,025 |

**(a) Calculation of carrying amount:**

Original cost = ₹40,000 lakhs

Depreciation for 3 years = [(40,000-1000) ×3/8] = ₹14,625 lakhs

Carrying amount on 31-12-20X1 = [40,000-14,625] = ₹25,375 lakhs

**(b) Value in use = ₹19,025 lakhs**

(c) Recoverable amount = higher of value in use and net selling price i.e. ₹20,000 lakhs.

**Recoverable amount** = ₹20,000 lakhs

(d) **Impairment Loss** = ₹(25,375-20,000) = ₹5,375 lakhs

(e) **Revised carrying amount** = ₹(25,375-5,375) = ₹20,000 lakhs

(f) **Depreciation charge for 20X2** = (20,000-1000)/5 = ₹3,800 lakhs

## Question 2

*X Ltd. is having a plant (asset) carrying amount of which is ₹100 lakhs on 31.3.20X1. Its balance useful life is 5 years and residual value at the end of 5 years is ₹5 lakhs. Estimated future cash flow from using the plant in next 5 years are:*

| For the year ended on | Estimated cash flow (₹ in lakhs) |
|---|---|
| 31.3.20X2 | 50 |
| 31.3.20X3 | 30 |
| 31.3.20X4 | 30 |
| 31.3.20X5 | 20 |
| 31.3.20X6 | 20 |

*Calculate "value in use" for plant if the discount rate is 10% and also calculate the recoverable amount if net selling price of plant on 31.3.20X1 is ₹60 lakhs.*

**Answer**

**Present value of future cash flow**

| *Year ended* | *Future Cash Flow* | *Discount @ 10% Rate* | *Discounted cash flow* |
|---|---|---|---|
| 31.3.20X2 | 50 | 0.909 | 45.45 |
| 31.3.20X3 | 30 | 0.826 | 24.78 |
| 31.3.20X4 | 30 | 0.751 | 22.53 |
| 31.3.20X5 | 20 | 0.683 | 13.66 |
| 31.3.20X6 | 20 | 0.620 | 12.40 |
| | | | 118.82 |
| Present value of residual price on 31.3.20X6 = 5 × 0.620 | | | 3.10 |
| Present value of estimated cash flow by use of an asset and residual value, which is called "value in use". | | | 121.92 |

If net selling price of plant on 31.3.20X1 is ₹60 lakhs, the recoverable amount will be higher of ₹121.92 lakhs (value in use) and ₹60 lakhs (net selling price), hence recoverable amount is ₹121.92 lakhs.

## Question 3

*G Ltd., acquired a machine on 1st April, 20X0 for ₹7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 20X4, the carrying value of the machine was reassessed at ₹5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March, 20X6, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only ₹79 lakhs. You are required to calculate the loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd. G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.*

**Answer**

**Statement Showing Impairment Loss**

| | ***(₹ in crores)*** |
|---|---|
| Carrying amount of the machine as on 1st April, 20X0 | 7.00 |
| Depreciation for 4 years i.e. 20X0-20X1 to 20X3-20X $\frac{7 \text{ crores}}{7 \text{ years}} \times 4\,years$ | (4.00) |
| Carrying amount as on 31.03.20X4 | 3.00 |
| *Add*: Upward Revaluation (credited to Revaluation Reserve account) | 2.10 |
| Carrying amount of the machine as on 1st April, 20X4 (revalued) | 5.10 |
| *Less*: Depreciation for 2 years i.e. 20X4-20X5& 20X5-20X6 $\frac{5.10 \text{ crores}}{3 \text{ years}} \times 3 \text{ years}$ | (3.40) |
| Carrying amount as on 31.03.20X6 | 1.70 |
| *Less*: Recoverable amount | (0.79) |
| Impairment loss | 0.91 |
| *Less*: Balance in revaluation reserve as on 31.03.20X6: | |
| Balance in revaluation reserve as on 31.03.20X4 | 2.10 |
| *Less*: Enhanced depreciation met from revaluation reserve 20X4-20 X 5 & 20X5-20 X 6 = [(1.70 – 1.00) x 2 years] (1.40) | |
| Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 "Impairment of Assets" | (0.70) |
| Impairment Loss to be debited to profit and loss account | 0.21 |

## Question 4

*X Ltd. purchased a Property, Plant and Equipment four years ago for ₹150 lakhs and depreciates it at 10% p.a. on straight line method. At the end of the fourth year, it has revalued the asset at ₹75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of revaluation, the market price is ₹67.50 lakhs and expected disposal costs are ₹3 lakhs. What will be the treatment in respect of impairment loss on the basis that fair value for revaluation purpose is determined by market value and the value in use is estimated at ₹60 lakhs?*

**Answer**

**Treatment of Impairment Loss**

As per para 57 of AS 28 "Impairment of assets", if the recoverable amount (higher of net selling price and its value in use) of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. In the given case, net selling price is ₹64.50 lakhs (₹67.50 lakhs – ₹3 lakhs) and value in use is ₹60 lakhs. Therefore, recoverable amount will be ₹64.50 lakhs. Impairment loss will be calculated as ₹10.50 lakhs [₹75 lakhs (Carrying Amount after revaluation - Refer Working Note) less ₹64.50 lakhs (Recoverable Amount)].

Thus impairment loss of ₹10.50 lakhs should be recognised as an expense in the Statement of Profit and Loss immediately since there was downward revaluation of asset which was already charged to Statement of Profit and Loss.

**Working Note:**

**Calculation of carrying amount of the Property, Plant and Equipment at the end of the fourth year on revaluation**

| | ***(₹ in lakhs)*** |
|---|---|
| Purchase price of a Property, Plant and Equipment | 150.00 |
| Less: Depreciation for four years [(150 lakhs / 10 years) x 4 years] | (60.00) |
| Carrying value at the end of fourth year | 90.00 |
| Less: Downward revaluation charged to profit and loss account | (15.00) |
| Revalued carrying amount | 75.00 |

## Question 5

*Write short note on impairment of asset and its application to inventory.*

**Answer**

The objective of AS 28 'Impairment of Assets' is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this Standard requires the enterprise to recognize an impairment loss.

- If carrying amount < = Recoverable amount : Asset is not impaired
- If carrying amount > Recoverable amount : Asset is impaired Impairment Loss = Carrying Amount – Recoverable Amount

Recoverable amount is the higher of net selling price and its value in use This standard should be applied in accounting for the impairment of all assets, other than (i) inventories (AS 2, Valuation of Inventories); (ii) assets arising from construction contracts (AS 7, Accounting for Construction Contracts); (iii) financial assets, including investments that are included in the scope of AS 13, Accounting for Investments; and (iv) deferred tax assets (AS 22, Accounting for Taxes on Income). AS 28 does not apply to inventories, assets arising from construction contracts, deferred tax assets or investments because other accounting standards applicable to these assets already contain specific requirements for recognizing and measuring the impairment related to these assets.

## Question 6

*A publisher owns 150 magazine titles of which 70 were purchased and 80 were self-created. The price paid for a purchased magazine title is recognized as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognized as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for each magazine title. Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economic lives and replace them immediately with new titles for the same customer segment. What is the cash-generating unit for an individual magazine title?*

**Answer**

It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other titles in the customer segment, cash inflows from direct sales and advertising are identifiable for each title. In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis.

Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent of each other and that each magazine title is a separate cash-generating unit.

## Question 7

*An asset does not meet the requirements of environment laws which have been recently enacted. The asset has to be destroyed as per the law. The asset is carried in the Balance Sheet at the year end at ₹6,00,000. The estimated cost of destroying the asset is ₹70,000. How is the asset to be accounted for?*

**Answer**

As per AS 28 "Impairment of Assets", impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount, where recoverable amount is the higher of an asset's net selling price[*] and its value in use[**]. In the given case, recoverable amount will be nil [higher of value in use (nil) and net selling price (negative ₹70,000)]. Thus impairment loss will be calculated as ₹6,00,000 [carrying amount (₹6,00,000) – recoverable amount (nil)]. Therefore, asset is to be fully impaired and impairment loss of ₹6,00,000 has to be recognized as an expense immediately in the statement of Profit and Loss as per para 58 of AS 28.

Further, as per para 60 of AS 28, When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an enterprise should recognise a liability if, and only if, that is required by another Accounting Standard. Hence, the entity should recognize liability for cost of disposal of ₹70,000 as per AS 10 & 29.

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* *Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. In the given case, Net Selling Price = Selling price – Cost of disposal = Nil – ₹70,000 = (₹70,000)*

** *Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. In the given case, value in use is nil.*

## Question 8

*Venus Ltd. has a fixed asset, which is carried in the Balance Sheet on 31.3.20X1 at ₹500 lakhs. As at that date the value in use is ₹400 lakhs and the net selling price is ₹375 lakhs.*

*From the above data:*

*(i) Calculate impairment loss.*

*(ii) Prepare journal entries for adjustment of impairment loss.*

*(iii) Show, how impairment loss will be shown in the Balance Sheet.*

**Answer**

(i) Recoverable amount is higher of value in use ₹400 lakhs and net selling price ₹375 lakhs.

Recoverable amount = ₹400 lakhs

Impairment loss = Carried Amount – Recoverable amount

= ₹500 lakhs – ₹400 lakhs = ₹100 lakhs.

(ii) Journal Entries

| | **Particulars** | **Dr. Amount (₹ in lakhs)** | **Cr. Amount (₹ in lakhs)** |
|---|---|---|---|
| (i) | Impairment loss account Dr. | 100 | |
| | To Provision for Accumulated Impairment Loss Account | | 100 |
| | (Being the entry for accounting impairment loss) | | |
| (ii) | Profit and loss account Dr. | 100 | |
| | To Impairment loss | | 100 |
| | (Being the entry to transfer impairment loss to profit and loss account) | | |

**(iii) Balance Sheet of Venus Ltd. as on 31.3.20X1**

| | (₹ in lakhs) |
|---|---|
| Fixed Asset | |
| Asset less depreciation | 500 |
| Less: Impairment loss | (100) |
| | 400 |

## Question 9

*Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 20X1 for ₹60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 20X1-20X2 the carrying amount was ₹41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch ₹36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of ₹54 crore per annum and has a carrying amount of ₹3.46 crore. All such machines put together could fetch a sum of ₹4.44 crore if disposed. Discuss the applicability of Impairment loss.*

**Answer**

As per provisions of AS 28 "Impairment of Assets", impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit which is group of asset to which the damaged machine belongs is not impaired; and the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.

## Question 10

*From the following details of an asset*

*(i) Find out impairment loss*

*(ii) Treatment of impairment loss*

*(iii) Current year depreciation Particulars of asset:*

| | |
|---|---:|
| Cost of asset | ₹56 lakhs |
| Useful life period | 10 years |
| Salvage value | Nil |
| Current carrying value | ₹27.30 lakhs |
| Useful life remaining | 3 years |
| Recoverable amount | ₹12 lakhs |
| Upward revaluation done in last year | ₹14 lakhs |

**Answer**

According to AS 28 "Impairment of Assets", an impairment loss on a revalued asset is recognised as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

| **Impairment Loss and its treatment** | ₹ |
|---|---:|
| Current carrying amount (including revaluation amount of ₹14 lakhs) | 27,30,000 |
| Less: Current recoverable amount | (12,00,000) |
| Impairment Loss | 15,30,000 |
| Impairment loss charged to revaluation reserve | 14,00,000 |
| Impairment loss charged to profit and loss account | 1,30,000 |

After the recognition of an impairment loss, the depreciation (amortization) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

In the given case, the carrying amount of the asset will be reduced to

₹12,00,000 after impairment. This amount is required to be depreciated over remaining useful life of 3 years (including current year). Therefore, the depreciation for the current year will be ₹4,00,000.

## Question 11

*A plant was acquired 15 years ago at a cost of ₹5 crores. Its accumulated depreciation as at 31st March, 20X1 was ₹4.15 crores. Depreciation estimated for the financial year 20X1-20X2 is ₹25 lakhs. Estimated Net Selling Price as on 31st March, 20X1 was ₹30 lakhs, which is expected to decline by 20 per cent by the end of the next financial year.*

*Its value in use has been computed at ₹35 lakhs as on 1st April, 20X1, which is expected to decrease by 30 per cent by the end of the financial year.*

*(i) Assuming that other conditions for applicability of the impairment Accounting Standard are satisfied, what should be the carrying amount of this plant as at 31st March, 20X2?*

*(ii) How much will be the amount of write off for the financial year ended 31st March, 20X2?*

*(iii) If the plant had been revalued ten years ago and the current revaluation reserves against this plant were to be ₹12 lakhs, how would you answer to questions (i) and (ii) above?*

*(iv) If the value in use was zero and the enterprise were required to incur a cost of ₹2 lakhs to dispose of the plant, what would be your response to questions (i) and (ii) above?*

**Answer**

As per AS 28 "Impairment of Assets", if the recoverable amount[1] of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount and that reduction is an impairment loss. An impairment loss on a revalued asset is recognized as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

In the given case, recoverable amount (higher of asset's net selling price and value in use) will be ₹24.5 lakhs on 31.3.20X2 according to the provisions of AS 28 [Refer working note].

1 Recoverable amount is the higher of an asset's net selling price and its value in use.

| | | (₹ in lakhs) |
|---|---|---|
| (i) | Carrying amount of plant (after impairment) as on 31st March, 20X2 | 24.50 |
| (ii) | Amount of write off (impairment loss) for the financial year ended 31st March, 20X2 [₹60 lakhs – ₹24.5 lakhs] | 35.50 |
| (iii) | If the plant had been revalued ten years ago | |
| | Debit to revaluation reserve | 12.00 |
| | Amount charged to profit and loss account (₹35.50 lakhs – ₹12 lakhs) | 23.50 |
| (iv) | If Value in use is zero | |
| | Value in use (a) | Nil |
| | Net selling price (b) | (-)2.00 |
| | Recoverable amount [higher of (a) and (b)] | Nil |
| | Carrying amount (closing book value) | Nil |
| | Amount of write off (impairment loss) (₹60 lakhs – Nil) | 60.00 |
| | Entire book value of plant will be written off and charged to profit and loss account. | |

**Working Note:**

**Calculation of Closing Book Value, Estimated Net Selling Value and Estimated Value in Use of Plant at 31st March, 20X2**

| | (₹ in lakhs) |
|---|---|
| Opening book value as on 1.4.20X1 (₹500 lakhs – ₹415 lakhs) | 85 |
| Less: Depreciation for financial year 20X1–20X2 | (25) |
| Closing book value as on 31.3.20X2 | 60 |
| Estimated net selling price as on 1.4.20X1 | 30 |
| Less: Estimated decrease during the year (20% of ₹30 lakhs) | (6) |
| Estimated net selling price as on 31.3.20X2 | 24 |
| Estimated value in use as on 1.4.20X1 | 35.0 |
| Less: Estimated decrease during the year (30% of ₹35 lakhs) | (10.5) |
| Estimated value in use as on 31.3.20X2 | 24.5 |

CHAPTER 15

# Accounting Standard 15 Employee Benefits

## Question 1

*What are the kinds of employees covered in the revised AS 15 and whether a formal employer employee relationship is necessary or not, for benefits to be covered under the Standard?*

(*Source: Illustration 1, Study Material*)

**Answer**

The Standard does not define the term "employee". Paragraph 6 of the Standard states that 'an employee may provide services to an enterprise on a full time, part time, permanent, casual or temporary basis and the term would also include the whole-time directors and other management personnel. The Standard is applicable to all forms of employer employee relationships. There is no requirement for a formal employer employee relationship. Several factors need to be considered to determine the nature of relationship.

Generally, 'outsourcing contracts' may not meet the definition of employer - employee relationship. However, such contracts need to be carefully examined to distinguish between a "contract of service" and a "contract for services". A 'contract for services' implies a contract for rendering services, e.g., professional or technical services which is subject to limited direction and control whereas a 'contract of service' implies a relationship of an employer and employee, and the person is obliged to obey orders in the work to be performed and as to its mode and manner of performance.

## Question 2

*Whether an enterprise is required to provide for employee benefits arising from informal practices?*

(*Source: Illustration 2, Study Material*)

**Answer**

Paragraph 3(c) of the Standard defines employee benefits to include those informal practices that give rise to an obligation where the enterprise has no realistic alternative but to pay employee benefits. The historical pattern of granting such benefits, the expectation created and the impact on the relationship with employees in the event such benefit is withdrawn should be considered in determining whether the informal practice gives rise to a benefit covered by the Standard. For example, where an employer has a practice of making a lumpsum payment on occasion of a festival or regularly grants advances against informal benefits to employees it would be necessary to provide for such benefits.

Careful judgement should be applied in assessing whether an obligation has arisen particularly in instances where an enterprise's practice is to provide improvements only during the collective bargaining process and not during any informal process. If the employer has not set a pattern of benefits that can be projected reliably to give rise to an obligation there is no requirement to provide for the benefits.

However, if the practice established by an employer was that of a consistent benefit granted either as part of union negotiations or otherwise that clearly established a pattern (e.g., a cost of living adjustment or fixed rupee increase), it could be concluded that an obligation exists and that those additional benefits should be included in the measurement of the benefit obligation.

Employee benefits include:

(a) Short-term employee benefits (e.g., wages, salaries, paid annual leave and sick leave, profit sharing bonuses etc. (payable within 12 months of the year-end) and non-monetary benefits for current employees.

(b) Post-employment benefits (e.g., gratuity, pension, provident fund, post- employment medical care etc.).

(c) long-term employee benefits (e.g., long-service leave, long-term disability benefits, bonuses not wholly payable within 12 months of the year end etc.), and

(d) termination benefits (e.g. VRS payments)

The Standard lays down recognition and measurement criteria and disclosure requirements for the above four types of employee benefits separately.

## Question 3

*Entity XY is required to pay salary of ₹ 2 crore for the year 20X1-X2. It actually paid a salary of ₹ 1.90 crore up to 31st March 20X2, and balance in April 20X2. Determine the actual costs to be recognized in the year 20X1-X2 and any amounts to be shown through balance sheet.*

(*Source: Illustration 3, Study Material*)

**Answer**

| | |
|---|---|
| Total expense for the year (20X1-X2) | ₹ 2 crore |
| Amount to be shown under liability (unpaid) | ₹ 2 crore – 1.90 ₹crore |
| | = ₹ 10 lakhs |

## Question 4

*Whether an entitlement to earned leave which can be carried forward to future periods is a short -term employee benefit or a long-term employee benefit.*

(*Source: Illustration 4, Study Material*)

**Answer**

Paragraph 7.2 of the Standard defines 'Short-term' benefits as employee benefits (other than termination benefits) which fall due wholly within twelve months after the end of the period in which the employees render the related service. Paragraph 8(b) of the Standard illustrates the term 'Short -term benefits' to include "short term compensated absences (such as paid annual leave) where the absences are expected to occur within twelve months after the end of the period in which the employees render the related employee service".

Paragraph 7.2 of the Standard uses "falls due" as the basis, paragraph 8(b) of the Standard uses "expected to occur" as the basis to illustrate classification of short term compensated absences. A reading of paragraph 8(b) together with paragraph 7.2 would imply that the classification of short -term compensated absences should be only when absences have "fallen due" and are also "expected to occur". In other words, where employees are entitled to earned leave which can be carried forward to future periods, the benefit would be a 'short-term benefit' provided the employee is entitled to either encash or utilise the benefit during the twelve months after the end of the period when the employee became entitled to the leave and is also expected to utilise the leave.

Where there are restrictions on encashment and/or availment, clearly the compensated absence has not fallen due and the benefit of compensated absences is more likely to be a long-term benefit. For example, where an employee has 100 days of earned leave which he is entitled to an unlimited carry forward, but the rules of the enterprise allow him to encash/utilise only 30 days during the next twelve months, the benefit would be considered as a 'long-term' benefit. In some situations, where there is no restriction but the absence is not expected to wholly occur in the next twelve months, the benefit should be considered as 'long-term'. For example, where an employee has 400 days carry forward earned leave and the past pattern indicates that the employees are unlikely to avail / encash the entire carry forward during the next twelve months, the benefit would not be 'short-term'.

Whilst it is necessary to consider the earned leave which "falls due", the pattern of actual utilisation/ encashment by employees, although reflective of the behavioural pattern of employees, does determine the status of the benefit, i.e., whether 'short-term' or 'long-term'. The value of short-term benefits should be determined without discounting and if the benefit is determined as long-term, it would be recognised and measured as "Other long-term benefits" in accordance with paragraph 129 of the Standard.

The categorisation in 'short-term' or 'long-term' employee benefits should be done on the basis of the overall behavioural pattern of all the employees of the enterprise and not on individual basis.

## Question 5

*In case an enterprise allows unutilised employee benefits, e.g., medical care, leave travel, etc., to be carried forward, whether it is required to recognise a provision in respect of carried forward benefits.*

(*Source: Illustration 5, Study Material*)

**Answer**

A provision should be recognised for all benefits (conditional or unconditional) which an employee becomes entitled to as a result of rendering of the service and should be recorded as part of the cost of service rendered during the period in which the service was rendered which resulted the entitlement. In estimating the cost of such benefit the probability of the employee availing such benefit should be considered.

## Question 6

*Omega Limited belongs to the engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of ₹ 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 2 lakhs instead of ₹ 5 lakhs. The average remaining life of the employees is estimated to be 6 years. You are required to advise the company on the following items from the viewpoint of finalization of accounts, taking note of the mandatory accounting standards.*

(*Source: Illustration 6, Study Material*)

**Answer**

According to AS 15 (Revised 2005) 'Employee Benefits', actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense. Therefore, surplus amount of ₹ 6 lakhs is required to be credited to the profit and loss statement of the current year.

## Question 7

*As on 1st April, 20X1 the fair value of plan assets was ₹ 1,00,000 in respect of a pension plan of Zeleous Ltd. On 30th September, 20X1 the plan paid out benefits of*

*₹ 19,000 and received inward contributions of ₹ 49,000. On 31st March, 20X2 the fair value of plan assets was ₹ 1,50,000 and present value of the defined benefit obligation was ₹ 1,47,920. Actuarial losses on the obligations for the year 20X1- 20X2 were ₹ 600.*

*On 1st April, 20X1, the company made the following estimates, based on its market studies, understanding and prevailing prices.*

| | *%* |
|---|---|
| *Interest & dividend income, after tax payable by the fund* | *9.25* |
| *Realised and unrealised gains on plan assets (after tax)* | *2.00* |
| *Fund administrative costs* | *(1.00)* |
| *Expected Rate of Return* | *10.25* |

*You are required to find the expected and actual returns on plan assets.*

(*Source: Illustration 7, Study Material*)

**Answer**

**Computation of Expected and Actual Returns on Plan Assets**

| | | ₹ |
|---|---|---|
| Return on ₹ 1,00,000 held for 12 months at 10.25% | | 10,250 |
| Return on ₹ 30,000 (49,000-19,000) held for six months at 5% (equivalent to 10.25% annually, compounded every six months) | | 1,500 |
| Expected return on plan assets for 20X1-20X2 | | 11,750 |
| Fair value of plan assets as on 31 March, 20X2 | | 1,50,000 |
| *Less:* Fair value of plan assets as on 1 April,20X1 1,00,000 | | |
| Contributions received | 49,000 | (1,49,000) |
| | | 1,000 |
| *Add:* Benefits paid | | 19,000 |
| Actual return on plan assets | | 20,000 |

Alternatively, the above question may be solved without giving compound effect to rate of return.

## Question 8

*Rock Star Ltd. discontinues a business segment. Under the agreement with employee's union, the employees of the discontinued segment will earn no further benefit. This is a curtailment without settlement, because employees will continue to receive benefits for services rendered before discontinuance of the business segment. Curtailment reduces the gross obligation for various reasons including change in actuarial assumptions made before curtailment. If the benefits are determined based on the last pay drawn by employees, the gross obligation reduces after the curtailment because the last pay earlier assumed is no longer valid.*

*Rock Star Ltd. estimates the share of unamortized service cost that relates to the part of the obligation at ₹ 18 (10% of ₹ 180). Calculate the gain from curtailment and liability after curtailment to be recognised in the balance sheet of Rock Star Ltd. on the basis of given information:*

*(a) Immediately before the curtailment, gross obligation is estimated at ₹ 6,000 based on current actuarial assumption.*

*(b) The fair value of plan assets on the date is estimated at ₹ 5,100.*

*(c) The unamortized past service cost is ₹ 180.*

*(d) Curtailment reduces the obligation by ₹ 600, which is 10% of the gross obligation.*

(*Source: Illustration 8, Study Material*)

**Answer**

Gain from curtailment is estimated as under:

| | ₹ |
|---|---:|
| Reduction in gross obligation | 600 |
| *Less*: Proportion of unamortised past service cost | (18) |
| Gain from curtailment | 582 |

The liability to be recognised after curtailment in the balance sheet is estimated as under:

| | ₹ |
|---|---:|
| Reduced gross obligation (90% of ₹ 6,000) | 5,400 |
| *Less*: Fair value of plan assets | (5,100) |
| | 300 |
| *Less*: Unamortised past service cost (90% of ₹ 180) | (162) |
| Liability to be recognised in the balance sheet | 138 |

## Question 9

*An employee Roshan has joined a company XYZ Ltd. in the year 20X1. The annual emoluments of Roshan as decided is ₹ 14,90,210. The company also has a policy of giving a lump sum payment of 25% of the last drawn annual salary of the employee for each completed year of service if the employee retires after completing minimum 5 years of service. The salary of the Roshan is expected to grow @ 10% per annum.*

*The company has inducted Roshan in the beginning of the year and it is expected that he will complete the minimum five year term before retiring. Thus he will get 5 yearly increment.*

*What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined Benefit obligation? Also calculate the current service cost and the interest cost to be charged per year assuming a discount rate of 8%.*

*(P.V factor for 8% - 0.735, 0.794, 0.857, 0.926, 1)*

(*Source: Illustration 9, Study Material*)

**Answer**

**Calculation of Defined Benefit Obligation (DBO)**

Expected last drawn salary = ₹ 14,90,210 x 110% x 110% x 110% x 110% x 110%

= ₹ 24,00,000

Defined Benefit Obligation (DBO) = ₹ 24,00,000 x 25% x 5 = ₹ 30,00,000

Amount of ₹ 6,00,000 will be charged to Profit and Loss Account of the company every year as cost for Defined Benefit Obligation.

**Calculation of Current Service Cost**

| Year | Equal apportioned amount of DBO [i.e. ₹ 30,00,000/5 years] | Discounting @ 8% PV factor | Current service cost (Present Value) |
|---|---|---|---|
| a | b | c | d = b x c |
| 1 | 6,00,000 | 0.735 (4 Years) | 4,41,000 |
| 2 | 6,00,000 | 0.794 (3 Years) | 4,76,400 |
| 3 | 6,00,000 | 0.857 (2 Years) | 5,14,200 |
| 4 | 6,00,000 | 0.926 (1 Year) | 5,55,600 |
| 5 | 6,00,000 | 1 (0 Year) | 6,00,000 |

**Calculation of Interest Cost to be charged per year**

| *Year* | *Opening balance* | *Interest cost* | *Current service cost* | *Closing balance* |
|---|---|---|---|---|
| **a** | **b** | **c = b x 8%** | **d** | **e = b + c + d** |
| 1 | 0 | 0 | 4,41,000 | 4,41,000 |
| 2 | 4,41,000 | 35,280 | 4,76,400 | 9,52,680 |
| 3 | 9,52,680 | 76,214 | 5,14,200 | 15,43,094 |
| 4 | 15,43,094 | 1,23,447 | 5,55,600 | 22,22,141 |
| 5 | 22,22,141 | 1,77,859* | 6,00,000 | 30,00,000 |

*Due to approximations used in calculation, this figure is adjusted accordingly.

## Question 10

*What are the types of Employees benefits and what is the objective of Introduction of this Standard i.e. AS 15?*

**Answer**

There are four types of employee benefits according to AS 15 (Revised 2005). They are:

(a) short-term employee benefits, such as wages, salaries and social security contributions (e.g., contribution to an insurance company by an employer to pay for medical care of its employees), paid annual leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

(b) post-employment benefits such as gratuity, pension, other retirement benefits, post-employment life insurance and post-employment medical care;

(c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation; and

(d) termination benefits.

Because each category identified in (a) to (d) above has different characteristics, this Statement establishes separate requirements for each category.

The objective of AS 15 is to prescribe the accounting and disclosure for employee benefits. The statement requires an enterprise to recognise:

(a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

(b) an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

## Question 11

*A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food and stay during the travel. Alternatively, employees can claim a lump sum amount equal to one month pay last drawn.*

*The company's contentions in this matter are:*

*(i) Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.*

*(ii) Since it is not related to the length of service of the employees, it is accounted for on claim basis.*

*State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer.*

**Answer**

The present case falls under the category of defined benefit scheme under Para 49 of AS 15 (Revised) "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. Thus,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15 (Revised).

(2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

## Question 12

*The following data apply to 'X' Ltd. defined benefit pension plan for the year ended 31.03.20X2 calculate the actual return on plan assets:*

| | |
|---|---|
| *- Benefits paid* | *2,00,000* |
| *- Employer contribution* | *2,80,000* |
| *- Fair market value of plan assets on 31.03.20X2* | *11,40,000* |
| *- Fair market value of plan assets as on 31.03.20X1* | *8,00,000* |

**Answer**

| | ₹ |
|---|---|
| Fair value of plan assets on 31.3.20X1 | 8,00,000 |
| *Add:* Employer contribution | 2,80,000 |
| *Less:* Benefits paid | (2,00,000) |
| (A) | 8,80,000 |
| Fair market value of plan assets at 31.3.20X2 (B) | 11,40,000 |
| Actual return on plan assets (B-A) | 2,60,000 |

## Question 13

*The fair value of plan assets of Anupam Ltd. was ₹ 2,00,000 in respect of employee benefit pension plan as on 1st April, 20X1. On 30th September, 20X1 the plan paid out benefits of ₹ 25,000 and received inward contributions of ₹ 55,000. On 31st March, 20X2 the fair value of plan assets was ₹ 3,00,000. On 1st April, 20X1 the company made the following estimates, based on its market studies and prevailing prices.*

| | % |
|---|---|
| *Interest and dividend income (after tax) payable by fund* | *10.25* |
| *Realized gains on plan assets (after tax)* | *3.00* |
| *Fund administrative costs* | *(3.00)* |
| *Expected rate of return* | *10.25* |

*Calculate the expected and actual returns on plan assets as on 31 st March, 20X2, as per AS 15.*

**Answer**

Computation of Expected Returns on Plan Assets as on 31st March, 20X2, as per AS 15

| | ₹ |
|---|---|
| Return on opening value of plan assets of ₹ 2,00,000 (held for the year) @ 10.25% | 20,500 |
| *Add*: Return on net gain of ₹ 30,000 (i.e. ₹ 55,000 – ₹ 25,000) during the year i.e. held for six months @ 5% (equivalent to 10.25% annually, compounded every six months) | 1,500 |
| Expected return on plan assets as on 31st March, 20X2 | 22,000 |

**Computation of Actual Returns on Plan Assets as on 31st March, 20X2, as per AS 15**

| | ₹ | ₹ |
|---|---|---|
| Fair value of Plan Assets as on 31st March, 20X2 | | 3,00,000 |
| *Less*: Fair value of Plan Assets 1st April, 20X1 as on | (2,00,000) | |
| *Add:* Contribution received as 30th September, 20X1 on | 55,000 | (2,55,000) |
| | | 45,000 |
| *Add*: Benefits paid as on 30th September, 20X1 | | 25,000 |
| Actual returns on Plan Assets an on 31st March, 20X2 | | 70,000 |

CHAPTER

# 16

# Accounting Standard 29 (Revised) Provisions, Contingent Liabilities and Contingent Assets

## Question 1

*At the end of the financial year ending on 31st December, 20X1, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:*

| | *Probability* | *Loss (₹)* |
|---|---|---|
| *In respect of five cases (Win)* | *100%* | |
| *Next ten cases (Win)* | *50%* | |
| *Lose (Low damages)* | *40%* | *1,20,000* |
| *Lose (High damages)* | *10%* | *2,00,000* |
| *Remaining five cases* | | |
| *Win* | *50%* | |
| *Lose (Low damages)* | *30%* | *1,00,000* |
| *Lose (High damages)* | *20%* | *2,10,000* |

*Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof.*

**Answer**

According to AS 29 (Revised) 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

(i) There is a present obligation arising out of past events but not recognized as provision.

(ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

(iii) The possibility of an outflow of resources embodying economic benefits is not remote.

(iv) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 50% and for remaining five cases is 50%. As per AS 29 (Revised), we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is remote, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 40% of ₹ 1,20,000 + 10% of ₹ 2,00,000
= ₹ 48,000 + ₹ 20,000 = ₹ 68,000

Expected loss in remaining five cases = 30% of ₹ 1,00,000 + 20% of ₹ 2,10,000
= ₹ 30,000 + ₹ 42,000 = ₹ 72,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of ₹ 10,40,000 (₹ 68,000 □ 10 + ₹ 72,000 □ 5) as contingent liability.

## Question 2

*EXOX Ltd. is in the process of finalising its accounts for the year ended 31st March, 20X2. The company seeks your advice on the following:*

(i) *The Company's sales tax assessment for assessment year 20X1-X2 has been completed on 14th February, 20X4 with a demand of ₹ 2.76 crore. The company paid the entire due under protest without prejudice to its right of appeal. The Company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore.*

(ii) *The Company has entered into a wage agreement in May, 20X2 whereby the labour union has accepted a revision in wage from June, 20X1. The agreement provided that the hike till May, 20X2 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September, 20X2.*

**Answer**

(i) Since the company is not appealing against the addition of ₹ 0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 20X4. The amount paid under protest can be kept under the heading 'Loans & Advances' and disclosed as a contingent liability of ₹ 2.10 crore.

(ii) The arrears for the period from June, 20X1 to March, 20X2 are required to be provided for in the accounts of the company for the year ended on 31st March, 20X2.

## Question 3

*When should provision be recognized as per provisions of AS 29? Explain in brief.*

**Answer**

A provision should be recognised only when: (a) An enterprise has a present obligation as a result of a past event; (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) A reliable estimate can be made of the amount of the obligation.

## Question 4

*Sun Ltd. has entered into a sale contract of ₹ 5 crores with X Ltd. during 20X1-20X2 financial year. The profit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 20X2-20X3 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of ₹ 1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 20X1-20X2 financial year. As on balance sheet date (31.3.20X2), the goods were not manufactured, and it was unlikely that Sun Ltd. will be able to meet the contractual obligation.*

(i) *Should Sun Ltd. provide for contingency as per AS 29?*

(ii) *Should provision be measured as the excess of compensation to be paid over the profit?*

**Answer**

(i) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognized. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Sun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for the contingency amounting ₹ 1.5 crores as per AS 29.

(ii) Provision should not be measured as the excess of compensation to be paid over the profit. The goods were not manufactured before 31st March, 20X2 and no profit had accrued for the financial year 20X1-20X2. Therefore, provision should be made for the full amount of compensation amounting ₹ 1.50 crores.

## Question 5

*An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. At 31st March 20X1, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary?*

**Answer**

As per para 29 of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event.

However, when environmental damage is caused, there may be no obligation to remedy the consequences. The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted.

In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean-up cost in the year in which the law is virtually certain to be enacted.

# QUESTION BANK

## Question 6

The company has not made provision for warrantee in respect of certain goods considering that the company can claim the warranty cost from the original supplier.

You are required to examine in line with the provisions of AS 29.

(*RTP May 2018*)

**Answer:**

As per provisions of AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision.

It is apparent from the question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it can be said that the accounting treatment adopted by the company with respect to warranty is not correct.

## Question 7

Sun Ltd. has entered into a sale contract of ₹5 crores with X Ltd. during 2015-2016 financial year. The profit on this transaction is ₹1 crore. The delivery of goods to take place during the first month of 2016-2017 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of ₹1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 2015-2016 financial year. As on balance sheet date (31.3.2016), the goods were not manufactured and it was unlikely that Sun Ltd. will be in a position to meet the contractual obligation.

(i) Should Sun Ltd. provide for contingency as per AS 29? Explain.

(ii) Should provision be measured as the excess of compensation to be paid over the profit?

(*MTP March 2018*) (*5 Marks*)

**Answer:**

**(i)** AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Sun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for the contingency amounting ₹1.5 crores as per AS 29.

**(ii)** Provision should not be measured as the excess of compensation to be paid over the profit. The goods were not manufactured before 31st March, 2016 and no profit had accrued for the financial year 2015-2016. Therefore, provision should be made for the full amount of compensation amounting ₹1.50 crores.

## Question 8

M/s. XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of ₹200 lakhs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS 29? You are required to explain in brief giving reasons for your answer.

(*RTP November 2018*)

**Answer:**

As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when

(a) an enterprise has a present obligation as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of ₹200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

## Question 9

An airline is required by law to overhaul its aircraft once in every five years. The pacific Airlines which operate aircrafts does not provide any provision as required by law in its final accounts. Discuss with reference to relevant Accounting Standard 29.

(*MTP August 2018*) (*5 Marks*)

**Answer:**

A provision should be recognized only when an enterprise has a present obligation arising from a past event or obligation. In the given case, there is no present obligation but a future one, therefore no provision is recognized as per AS 29.

The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts. Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts. Further, the enterprise can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation after completion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime. A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than five years.

## Question 10

XYZ Ltd. has not made provision for warrantee in respect of certain goods due to the fact that the company can claim the warranty cost from the original supplier. Hence the accountant of the company says that the company is not having any liability for warrantees on a particular date as the amount gets reimbursed. You are required to comment on the accounting treatment done by the XYZ Ltd. in line with the provisions of AS 29.

(*RTP November 2019*)

**Answer**

As per para 46 of AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.

It is apparent from the question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it is viewed that the accounting treatment adopted by the company with respect to warranty is not correct.

## Question 11

A Ltd. provides after sales warranty for two years to its customers. Based on past experience, the company has the following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period.

Less than 1 year: 2% provision

More than 1 year: 3% provision

The company has raised invoices as under:

| **Invoice Date** | **Amount (₹)** |
|---|---:|
| 11th February 2017 | 60,000 |
| 25th December, 2017 | 40,000 |
| 04th October, 2018 | 1,35,000 |

Calculate the provision to be made for warranty under AS-29 as at 31st March, 2018 and 31st March, 2019. Also compute amount to be debited to P & L account for the year ended 31st March, 2019.

(*November 2019, New Course, 5 Marks*)

**Answer**

Provision to be made for warranty under AS 29 'Provisions, Contingent Liabilities and Contingent Assets'

As at 31st March, 2018 = ₹ 60,000 x .02 + ₹ 40,000 x .03

= ₹ 1,200 + ₹ 1,200 = ₹ 2,400

As at 31st March, 2019 = ₹ 40,000 x .02 + ₹ 1,35,000 x .03

= ₹ 800 + ₹ 4,050 = ₹ 4,850

**Amount debited to Profit and Loss Account for year ended 31st March, 2019**

| | ₹ |
|---|---:|
| Balance of provision required as on 31.03.2019 | 4,850 |
| *Less*: Opening Balance as on 1.4.2018 | (2,400) |
| Amount debited to profit and loss account | 2,450 |

**Note:** No provision will be made on 31st March, 2019 in respect of sales amounting ₹ 60,000 made on 11th February, 2017 as the warranty period of 2 years has already expired.

## Question 12

With reference to AS 29, how would you deal with the following in the annual accounts of the company at the Balance Sheet dates:

(i) An organization operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten percent arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted.

(ii) During 2018-19 Ace Ltd. gives a guarantee of certain borrowings of Brew Ltd., whose financial condition at that time is sound. During 2019-20, the financial condition of Brew Ltd. deteriorates and on 31st December, 2019, it goes into liquidation. (Balance Sheet date 31-3-19).

(*May 2020*)

**Answer**

**(i)** The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is probable. Thus, a provision is recognized for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig. However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. So, no provision is required for the cost of extraction of oil at balance sheet date.

Ten per cent of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.

**(ii)** As per AS 29, for a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation.

The obligating event is the giving of the guarantee by Ace Ltd. for certain borrowings of Brew Ltd., which gives rise to an obligation. No outflow of benefits is probable at 31 March, 2019.Thus no provision is recognized. The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

During 2019-20, the financial condition of Brew Ltd. deteriorates and finally goes into liquidation. The obligating event is the giving of the guarantee, which gives rise to a legal obligation. At 31 March, 2020, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Thus, provision is recognized for the best estimate of the obligation.

## Question 13

With reference to AS29 “Provisions, Contingent Liabilities and Contingent Assets”, define:

(i) A Provision

(ii) A Liability

(iii) A Contingent Asset

(iv) Present Obligation

(*May 2016, 4 Marks*)

**Answer**

**(i)** ***A Provision*** is a liability which can be measured only by using a substantial degree of estimation.

**(ii)** **A *Liability*** is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

**(iii)** **A *Contingent asset*** is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

**(iv)** ***Present obligation -*** An obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

## Question 14

M/s. XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of ₹ 200 lacs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS-29? Explain in brief giving reasons for your answer.

(*November, 2016, 4 Marks*)

**Answer**

As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets’, a provision should be recognized when

(a) an enterprise has a present obligation as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of ₹ 200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

## Question 15

(a) How will you distinguish contingent assets with Contingent Liabilities. Explain in brief.

(b) Alpha Ltd. has entered into a sale contract of ₹ 7 crores with Gamma Ltd. during 2018-19 financial year. The profit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 2019-20 financial year. In case of failure of Alpha Ltd. to deliver within the schedule, a compensation of ₹2 crores is to be paid to Gamma Ltd. Alpha Ltd. planned to manufacture the goods during the last month of 2018-19 financial year. As on balance sheet date (31.3.2019), the goods were not manufactured and it was unlikely that Alpha Ltd. will be in a position to meet the contractual obligation. You are required to advise Alpha Ltd. on requirement o f provision for contingency in the financial statements for the year ended 31st March, 2019, in line with provisions of AS 29?

(*RTP, November, 2020*)

**Answer**

**(a)** **A Contingent liability is a** possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

A present obligation that arises from past events but is not recognized because:

(i) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) A reliable estimate of the amount of the obligation cannot be made.

An enterprise should not recognize a contingent liability but should be disclosed. A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote.

**Contingent assets** usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain. An enterprise should not recognize a contingent asset, since this may result in the recognition of income that may never be realized. However, when the realization of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate. A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and, the corresponding approving authority in the case of any other enterprise), where an inflow of economic benefits is probable. Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

**(b)** AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognized. Alpha Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Alpha Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Alpha Ltd. should provide for the contingency amounting ₹ 2 crores as per AS 29.

## Question 16

(i) XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of ₹ 200 lacs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS 29 ? Explain in brief giving reasons for your answer.

(ii) What is meant by "Restructuring Provision" as per AS 29? What costs are excluded while computing such provision as per the standard?

(*MTP, April, 2021*) (*5 marks*)

**Answer**

**(i)** As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when

- an enterprise has a present obligation as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of ₹ 200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

**(ii)** As per AS 29, a restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both: (a) necessarily entailed by the restructuring; and (b) Not associated with the ongoing activities of the enterprise. A restructuring provision does not include such costs as: (a) Retraining or relocating continuing staff; (b) Marketing; or (c) Investment in new systems and distribution networks.

## Question 17

(a) The company has not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier.

You are required to **examine** in line with the provisions of AS 29.

(b) Explain whether provision is required in the following situations in li ne with AS 29:

(i) There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation;

(ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.

(iii) There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.

(*RTP, May, 2021*)

**Answer**

**(a)** As per provisions of AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision.

It is apparent from the question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it can be said that the accounting treatment adopted by the company with respect to warranty is not correct.

**(b)** (i) There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation – Provision is recognised. Disclosures are required for the provision.

(ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources – No provision is recognised. Disclosures are required for the contingent liability.

(iii) There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote – No provision is recognised. No disclosure is required.

## Question 18

With reference to AS 29, how would you deal with the following in the Annual Accounts of the company at the Balance Sheet date:

(i) The company operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Eighty five percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and fifteen percent arise through the extraction of oil. At the balance sheet date, rig has been constructed but no oil has been extracted.

(ii) The Government introduces a number of changes to the taxation laws. As a result of these changes, the company will need to train a large proportion of its accounting and legal workforce in order to ensure continued compliances with tax law regulations. At the balance sheet date, no retraining of staff has taken place.

(*Suggested, November, 2020*) (*5 marks*)

**Answer**

**(i)** The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is probable. Thus, a provision is recognized for the best estimate of 85% of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig.

However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. So, no provision is required for the cost of extraction of oil at balance sheet date. 15% of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.

**(ii)** As per AS 29, a provision for restructuring costs is recognized only when the recognition criteria for provisions are met. A restructuring provision does not include costs as of retraining or relocating continuing staff.

The expenditures of training the staff related to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognized on the same basis as if they arose independently of a restructuring. At the balance sheet date, no such expenditure has been incurred hence no provision is required.

## Question 24

A Limited sells goods with unlimited right of return to its customers. The following pattern has been observed in the Return of Sales:

| Time frame of Return from date of purchase | % of Cumulative Sales |
|---|---|
| Between 0-1 month | 6% |
| Between 1-2 months | 7% |
| Between 2-3 months | 8% |

The Company has made Sales of ₹ 36 Lakhs in the month of January, ₹ 48 Lakhs in the month of February and of ₹ 60 Lakhs in the month of March. The Total Sales for the Financial Year have been ₹ 400 Lakhs and the Cost of Sales was ₹ 320 Lakhs. You are required to determine the amount of Provision to be made and Revenue to be recognized as on 31st March.

*(July, 2021 Suggested) (5 Marks)*

**Answer**

**Amount of provision**

The goods are sold with a right to return. The existence of such right gives rise to a present obligation on the company as per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets'. According to the standard, a provision should be created on the Balance sheet date, for sales returns after the Balance Sheet date, at the best estimate of the loss expected, along with any estimated incremental cost that would be necessary to resell the goods expected to be returned.

| Sales during | Sales value (₹ in lacs) | Sales value (cumulative) ₹ (in lacs) | Likely returns (%) | Likely returns ₹ (in lacs) | Provision @ 20% (₹ in lacs) (Refer W.N.) |
|---|---|---|---|---|---|
| March | 60 | 60 | 6% | 3.60 | 0.720 |
| February | 48 | 108 | 7% | 7.56 | 1.512 |
| January | 36 | 144 | 8% | 11.52 | 2.304 |
| Total | | | | 22.68 | 4.536 |

**Revenue to be recognized**

Revenue in respect of sale of goods is recognized fully at the time of sale itself assumed that the company has complied with the conditions stated in AS 9 relating to recognition of revenue in the case of sale of goods. As per AS 9, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) Seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods. AS 9 also provides that in case of retail sales offering a guarantee of ‘money back, if not completely satisfied, it may be appropriate to recognize the sale but to make a suitable provision for returns based on previous experiences.

Therefore, sale of ₹ 36 lakhs, ₹ 48 lakhs and ₹ 60 lakhs made in the months of January, February and March will be recognized at full value. Thus, total revenue to be recognized for RS. 400 lacs for the year.

**Working Note:**

**Calculation of Profit % on sales**

| | **(₹ *in lacs*)** |
|---|---|
| Sales for the year | 400 |
| *Less*: Cost of sales | (320) |
| Profit | 80 |

## Question 25

Saharsh Ltd. is engaged in manufacturing of electric home appliances. The company is in the process of finalizing its accounts for the year ended 31.3.2020 and needs your expert advice on the following issues in line with the provisions of AS 29:

(i) A case has been filed against the company in the consumer court and a notice for levy of a penalty of ₹ 20 lakhs has been received. The company has appointed a lawyer to defend the case for a fee of ₹ 2 lakhs. 50% of the fees has been paid and balance 50% will be paid after finalisation of the case. There are 75% chances that the penalty may not be levied.

(ii) The company had committed to supply a consignment worth ₹ 1 crore to one of its dealers by the year-end. As per the contract, if delivery is not made on time, a compensation of 15% is to be paid on the value of delayed/lost consignment. While the consignment was in transit, one of the trucks carrying goods worth ₹ 30 lakhs met with an accident. It was however covered by Insurance. According to the surveyor's report, the policy amount is collectable, subject to 10% deduction. Before closing the books of accounts, the company has received the information that the policy amount has been processed and the dealer has also claimed the compensation for the consignment of goods worth ₹ 30 lakhs which was in transit.

(*MTP*, *October 2021*) (*5 Marks*)

**Answer**

**(i)** As per AS 29, an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

Liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

In the given case, there are 75% chances that the penalty may not be levied. Accordingly, Saharsh Ltd. should not make the provision for penalty.

However, a provision should be made for remaining 50% fees of the lawyer in the financial statements of financial year 2019-2020.

**(ii)** Loss due to accident ₹ 30,00,000

| | | | |
|---|---|---|---|
| Insurance claim receivable by company = ₹ 30,00,000 x 90% | = | ₹ 27,00,000 | |
| Loss to be recognised in the books for 2019-2020 | | ₹ 3,00,000 | |
| Insurance claim receivable to be recorded in the books | | ₹ 27,00,000 | |

Compensation claim by dealer against company to be provided for in the books = ₹ 30,00,000 x 15% = ₹ 4,50,000.

## Question 26

(a) A company, incorporated as NPO under the Companies Act, is having main objective to promote the trade by organizing trade fairs / exhibitions. While organizing the trade fair and exhibitions, it decided to charge 5% contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies, 5% contingency charges are levied separately in the invoice, the contingency charges in respect of fairs organized by the company itself are inbuilt in the space rent charged from the participants. Both are credited to Income and Expenditure Account of the company.

The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/ exhibitors, etc., due to fire, terrorist attack, stampede, natural calamities and other public and third party liability. The chances of occurrence of these events are high because of large crowds visiting the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated.

The accounting treatment and disclosure was made by the company in its financial statements as: (i) 5% contingency charges are treated as income and matching provision for the same is also being made in accounts and (ii) suitable disclosure to this effect is also made in the notes forming part of accounts.

You are required to comment whether creation of provision for contingencies considering the facts and circumstances of the case is required in line with AS 29.

(b) An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. On 31st March 2021, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary considering the circumstances in line with provisions of AS 29?

(*RTP November 2021*)

**Answer**

**(a)** As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", a provision should be recognized when (a) An enterprise has a present obligation as a result of a past event and (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

From the above, it is clear that for the contingencies considered by the company, neither a present obligation exists because of past event, nor a reliable estimate can be made of the amount of the obligation. Accordingly, a provision cannot be recognized for such contingencies under the facts and circumstances of the case.

**(b)** As per AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event. However, when environmental damage is caused there may be no obligation to remedy the consequences. The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted. In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean-up cost in the year in which the law is virtually certain to be enacted.

## Question 27

Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2020. It seeks your advice in the following cases:

(i) Chaos Limited has filed a court case in 2014-2015 against its competitors. It became evident to its lawyers during the year ended 31st March, 2020 that Chaos Limited may lose the case and would have to pay ₹ 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.

(ii) A new regulation has been passed in 2019-2020 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2021. The company estimates an expenditure of ₹ 10,00,000 for the said upgrade.

(iii) The company gives one year warranty for its healthcare equipment under the contract of sale that it will make good any manufacturing defect by repair or replacement. As per past experience, it is probable that there will be 1% such cases and estimated cost of repair/replacement is estimated at 10% of such sale value. During the year, the company has made a sale of ₹ 5 crores.

Kindly give your answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29.

(*RTP May, 2022*)

**Answer**

**Principles for recognition of provisions:** As per AS 29, "a provision shall be recognised when:

(i) an entity has a present obligation (legal or constructive) as a result of a past event;

(ii) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(iii) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

**Accounting treatment under the given scenarios:**

(i) On 31st March, 2020, since it is evident to the lawyer that Chaos Limited may lose the case and also a reliable estimate of the outflow can be made as ₹ 3,00,000, there is a present obligation. Hence, provision should be recognised for ₹ 3,00,000 for the amount which may be required to settle the obligation.

(ii) Under new regulation, an entity is required to upgrade its facilities by 31st March, 2021. However, on 31st March, 2020, i.e. at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations. Hence, no provision should be recognized on 31st March, 2020 for upgrading the facilities by 31st March, 2021.

(iii) The obligating event is the sale of health care equipment with a warranty, which gives rise to a legal obligation. Here, an outflow of resources embodying economic benefits in settlement is probable for the warranties as a whole. Hence, a provision is recognized for the best estimate of the costs of making good under the warranty products sold before the end of the reporting period as follows:

Probability of warranty cases for the entity where repair/replacement may be required as per past experience = 1% of ₹ 5,00,00,000 = ₹ 5,00,000

Estimated cost of repair/replacement = ₹ 5,00,000 x 10% = ₹ 50,000.

## Question 28

*At the end of the financial year ending on 31stMarch, 2022, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:*

| ***Particulars*** | ***Probability*** | ***Loss (₹)*** |
|---|---:|---:|
| *In respect of five cases (Win)* | *100%* | - |
| *Next ten cases (Win)* | *50%* | - |
| *Lose (Low damages)* | *40%* | *12,00,000* |
| *Lose (High damages)* | *10%* | *20,00,000* |
| *Remaining five cases Win* | *50%* | - |
| *Lose (Low damages)* | *30%* | *10,00,000* |
| *Lose (High damages)* | *20%* | *21,00,000* |

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof as per AS - 29.

(*Suggested November, 2022*) (*4 Marks*)

**Answer**

According to AS 29 (Revised) 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

(i) There is a present obligation arising out of past events but not recognized as provision.

(ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

(iii) The possibility of an outflow of resources embodying economic benefits is not remote.

(iv) The amount of the obligation cannot be measured with sufficient rel iability to be recognized as provision.

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 50% and for remaining five cases is 50%. As per AS 29 (Revised), we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is remote, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 40% of ₹ 12,00,000 + 10% of ₹ 20,00,000
= ₹ 4,80,000 + ₹ 2,00,000
= 6,80,000

Expected loss in remaining five cases = 30% of ₹ 10,00,000 + 20% of ₹ 21,00,000
= ₹ 3,00,000 + ₹ 4,20,000
= ₹ 7,20,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of 1,04,00,000 (₹ 6,80,000 × 10 + ₹ 7,20,000 × 5) as contingent liability.

## Question 29

Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2022. It seeks your advice in the following cases:

(i) Chaos Limited entered into an agreement to supply 1 lac face masks to D Limited by 30th April, 2022 failing which it will have to pay a penalty of ₹ 10 per item not supplied. On 31st March, 2022 Chaos Limited assessed that it could only supply 50,000 face masks to D Limited by 30th April, 2022.

(ii) Chaos Limited has filed a court case in 2014-2015 against its competitors. It is evident to its lawyers that Chaos Limited may lose the case and would have to pay ₹ 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.

(iii) A new regulation has been passed in 2021-22 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2023. The company estimates an expenditure of ₹ 10,00,000 for the said upgrade.

Kindly give your answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29.

(*RTP November, 2022*)

**Answer**

**Principles for recognition of provisions:**

As per AS 29, "a provision shall be recognised when:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

Accounting treatment under the given scenarios:

(i) In this case, there is no present obligation arising out of a past event as the goods are scheduled for delivery on 30th April, 2022 and there is no delay as at 31st March, 2022. Hence, there is no present obligation to pay the penalty in the current year. Therefore, no provision can be recognized in the instant case.

(ii) On 31st March, 2022, since it is evident to the lawyer that Chaos Limited may lose the case and also a reliable estimate of the outflow can be made as ₹ 3,00,000, there is a present obligation. Hence, provision should be recognised for ₹ 3,00,000 for the amount which may be required to settle the obligation.

(iii) Under new regulation, an entity is required to upgrade its facilities by 31st March, 2023. However, on 31st March, 2022, i.e. at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations. Hence, no provision should be recognised on 31st March, 2022 for upgrading the facilities by 31st March, 2023.

CHAPTER

# 17

# Accounting Standard 4 Contingencies and Events Occurring after the Balance Sheet Date

**Question 1**

*In X Co. Ltd., theft of cash of ₹ 5 lakhs by the cashier in January, 20X1 was detected only in May, 20X1. The accounts of the company were not yet approved by the Board of Directors of the company.*

*Decide whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.20X1.*

(*Source: Illustration 1, Study Material*)

**Answer**

As per AS 4 (Revised) 'Contingencies and Events occurring after the Balance Sheet Date', an event occurring after the balance sheet date may require adjustment to the reported amounts of assets, liabilities, expenses or incomes.

If a fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognise the loss amounting ₹ 5,00,000 and adjust the accounts of the company for the year ended 31st March, 20X1.

**Question 2**

*An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.20X2. The accounting year of the company ended on 31.3.20X2. The accounts were approved on 30.6.20X2. The loss from earthquake is estimated at ₹ 30 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company.*

(*Source: Illustration 2, Study Material*)

**Answer**

AS 4 (Revised) "Contingencies and Events Occurring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.3.20X2. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 20X1- 20X2.

However, according to the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the earthquake has caused major destruction; therefore, fundamental accounting assumption of going concern would have to be evaluated. Considering that the going concern assumption is still valid, the fact of earthquake together with an estimated loss of ₹ 30 lakhs should be disclosed in the report of the approving authority for financial year 20X1-X2 to enable users of financial statements to make proper evaluations and decisions.

**Question 3**

*A company has filed a legal suit against the debtor from whom ₹ 15 lakh is recoverable as on 31.3.20X1. The chances of recovery by way of legal suit are not good as per legal opinion given by the counsel in April, 20X1. Can the company provide for full amount of ₹ 15 lakhs as provision for doubtful debts? Discuss.*

(*Source: Illustration 3, Study Material*)

**Answer**

As per AS 4 (Revised) “Contingencies and Events Occurring After the Balance Sheet Date”, assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. In the given case, company should make the provision for doubtful debts, as legal suit has been filed on 31st March, 20X1 and the chances of recovery from the suit are not good. Though, the actual result of legal suit will be known in future yet situation of non-recovery from the debtors exists before finalisation of financial statements. Therefore, provision for doubtful debts should be made for the year ended on 31st March, 20X1.

## Question 4

*In preparing the financial statements of R Ltd. for the year ended 31st March, 20X1, you come across the following information. State with reasons, how you would deal with this in the financial statements:*

*The company invested 100 lakhs in April, 20X1 before approval of Financial Statements by the Board of directors in the acquisition of another company doing similar business, the negotiations for which had started during the year.*

(*Source: Illustration 4, Study Material*)

**Answer**

AS 4 (Revised) defines "Events Occurring after the Balance Sheet Date" as those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Approving Authority in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 20X1. The disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 100 lakhs in April, 20X1 for the acquisition of another company should be disclosed in the report of the Approving Authority to enable users of financial statements to make proper evaluations and decisions.

## Question 5

*A Limited Company closed its accounting year on 30.6.20X1 and the accounts for that period were considered and approved by the board of directors on 20th August, 20X1. The company was engaged in laying pipeline for an oil company deep beneath the earth. While doing the boring work on 1.9.20X1 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of ₹ 80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.20X1.*

(*Source: Illustration 5, Study Material*)

**Answer**

AS 4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date defines 'events occurring after the balance sheet date' as 'significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors in the case of a company'. The given case is discussed in the light of the above-mentioned definition and requirements given in AS 4 (Revised). In this case the incidence, which was expected to push up cost, became evident after the date of approval of the accounts. So it is not an 'event occurring after the balance sheet date'.

## Question 6

*While preparing its final accounts for the year ended 31st March, 20X1 a company made a provision for bad debts @ 5% of its total trade receivables. In the last week of February, 20X1 a trade receivable for ₹ 2 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 20X1 the trade receivable became a bankrupt. Can the company provide for the full loss arising out of insolvency of the trade receivable in the final accounts for the year ended 31st March, 20X1?*

(*Source: Illustration 6, Study Material*)

**Answer**

As per Accounting Standard 4, Assets and Liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist estimation of amounts relating to conditions existing at the balance sheet date.

So full provision for bad debt amounting to ₹ 2 lakhs should be made to cover the loss arising due to the insolvency in the Final Accounts for the year ended 31st March, 20X1. It is because earthquake took place before the balance sheet date.

Had the earthquake taken place after 31st March, 20X1, then this would have been treated as non-adjusting event and only disclosure required as per AS 4 (Revised), would have been sufficient.

## Question 7

*Y Ltd. has book debts and has a doubt over recoverability of some of the book debts. The amount that cannot be recovered is not quantifiable. Thus, Y Ltd. is of the opinion that provision for doubtful debts should not be created. Y Ltd. creates provision for certain other expenses on estimated basis.*

*Whether contention of Y Ltd. is correct?*

(*Source: Illustration 7, Study Material*)

**Answer**

**As per AS 4, "Contingencies and Events Occurring After the Balance Sheet Date" if it is likely that a contingency will result in a loss to an entity then it should create provision for that contingency on the estimated basis.**

Based on the above, the contention that provision for doubtful debt is not be created merely because the amount is not quantifiable is not correct. Hence Y Ltd. should make provision in the books on the basis of estimation.

| |
|---|
| **Reference:** The students are advised to refer the full text of AS 4 (Revised) "Contingencies[1] and Events occurring after the Balance Sheet Date". |

## Question 8

*A Ltd. has sold its building for ₹ 50 lakhs to B Ltd. and has also given the possession to B Ltd. The book value of the building is ₹ 30 lakhs. As on 31st March, 20X1, the documentation and legal formalities are pending. The company has not recorded the sale and has shown the amount received as advance. Do you agree with this treatment?*

**Answer**

The economic reality and substance of the transaction is that the rights and beneficial interest in the property has been transferred although legal title has not been transferred. A Ltd. should record the sale and recognise the gain of ₹ 20 lakhs in its profit and loss account. The building should be derecognized in the financial statements.

## Question 9

*During the year 20X1-20X2, Raj Ltd. was sued by a competitor for ₹ 15 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Raj Ltd. provided for a sum of ₹ 10 lakhs in its financial statements for the year ended 31st March, 20X2. On 18th May, 20X2, the Court decided in favour of the party alleging infringement of the trademark and ordered Raj Ltd. to pay the aggrieved party a sum of ₹ 14 lakhs. The financial statements were prepared by the company's management on 30th April, 20X2, and approved by the board on 30th May, 20X2.*

**Answer**

As per AS 4 (Revised), adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

In the given case, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 20X1-X2 for which the provision was also made by it, the decision of the Court on 18th May, 20X2, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Raj Ltd. should adjust the provision upward by ₹ 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

Had the judgment of the Court been delivered on 1st June, 20X2, it would be considered as an event occurring after the approval of the financial statements which is not covered by AS 4 (Revised). In that case, no adjustment in the financial statements of 20X1-X2 would have been required.

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**1** *Pursuant to AS 29 'Provisions, Contingent Liabilities and Contingent Assets', becoming mandatory in respect of accounting periods commencing on or after 1st April, 2004, all paragraphs of AS 4 (Revised) dealing with contingencies stand withdrawn except to the extent they deal with impairment of assets not covered by any other AS. However, as per the Companies (Accounting Standards) Amendment Rules, 2016–30 March 2016, all paragraphs of this Standard that deal with contingencies are applicable only to the extent not covered by other Accounting Standards prescribed by the Central Government. For example, the impairment of financial assets such as impairment of receivables (commonly known as provision for bad and doubtful debts) is governed by this Standard*.

# QUESTION BANK

## Question 10

ABC Ltd. could not recover ₹ 10 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company were finalized for the year ended 31.3.2005 by making a provision @ 20% of the amount due from the said debtor. The debtor became bankrupt in April, 2005 and nothing is recoverable from him.

Do you advise the company to provide for the entire loss of ₹ 10 lakhs in the books of account for the year ended 31st March, 2005?

(*November 2005, 4 Marks*)

**Answer**

As per AS 4 'Contingencies and Events occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

In the given case, bankruptcy of the debtor in April, 2005 and consequent non-recovery of debt is an event occurring after the balance sheet date which materially affects the determination of profits for the year ended 31.3.2005. Therefore, the company should be advised to provide for the entire amount of ₹ 10 lakhs according to para 8 of AS 4.

## Question 11

X Ltd. entered into an agreement to sell its immovable property included in the Balance Sheet at ₹ 10 lacs to another company for ₹ 15 lacs. The agreement to sell was concluded on 28th February, 2006 and the sale deed was registered on 1st May, 2006. Comment with reference to AS 4.

(*November 2006, 4 Marks*)

***Answer***

According to para 13 of AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In the given case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 15th February, 2009 *i.e.* before the balance sheet date.

Registration of the sale deed on 30th April, 2009, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of immovable property is necessary in the financial statements for the year ended 31st March, 2009.

## Question 12

In X Co. Ltd., theft of cash of ₹ 5 lakhs by the cashier in January, 2007 was detected only in May, 2007. The accounts of the company were not yet approved by the Board of Directors of the company. Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.2007. Decide.

(*May 2007, 2 Marks*)

***Answer***

As per paragraph 13 of AS 4 (revised) 'Contingencies and Events occurring after the Balance Sheet Date', an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes.

If a fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognize the loss amounting ₹5,00,000 and adjust the accounts of the company for the year ended 31st March, 2007.

## Question 13

An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.2009. The accounting year of the company ended on 31.3.2009. The accounts were approved on 30.6.2009. The loss from earthquake is estimated at ₹ 30 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company?

(*November 2009, 2 Marks*)

**Answer**

Para 8.3 of AS 4 "Contingencies and Events Occuring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The destruction of warehouse due to earthquake did not exist on the balance sheet date *i.e.* 31.3.2009. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 2008-2009.

However, according to para 8.6 of the standard, unusual changes affecting the existence or sub-stratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the earthquake has caused major destruction; therefore fundamental accounting assumption of going concern is called upon. Hence, the fact of earthquake together with an estimated loss of ₹30 lakhs should be disclosed in the Report of the Directors for the financial year 2008-2009.

## Question 14

A Company follows April to March as its Financial Year. The Company recognizes cheques dated 31st March or before, received from customers after balance sheet date, but before approval of Financial statement by debiting cheques in hand A/c and crediting Debtors A/c. The cheques in hand is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques in hand are presented to bank in the month of April and are also realised in the same month in normal course after deposit in the bank. State with reasons, whether the collection of cheques bearing date 31st March or before, but received after Balance Sheet date is an adjusting event and how this fact is to be disclosed by the company?

(*May, 2010, 2 Marks*)

**Answer**

Even if the cheques bear the date 31st March or before, the cheques received after 31st March do not represent any condition existing on the balance sheet date *i.e.* 31st March. Thus, the collection of cheques after balance sheet date is not an adjusting event. Cheques that are received after the balance sheet date should be accounted for in the period in which they are received even though the same may be dated 31st March or before as per AS 4 "Contingencies and Events Occurring after the Balance Sheet Date". Moreover, the collection of cheques after balance sheet date does not represent any material change affecting financial position of the enterprise, so no disclosure in the Director's Report is necessary.

## Question 15

While preparing its final accounts for the year ended 31st March 2010, a company made a provision for bad-debts @ 4% of its total debtors (as per trend follows from the previous years). In the first week of March 2010 a debtor for ₹ 3,00,000 had suffered heavy loss due to an earthquake; the loss was not covered by an insurance policy. In April 2010 the debtor become a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March 2010.

(*November, 2010 & November 2011, 5 Marks*)

***Answer***

As per para 8 of AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustment to assets and liabilities are required for events occurring after the Balance Sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

A debtor for ₹3,00,000 suffered heavy loss due to earthquake in the first week of March, 2010 and he became bankrupt in April, 2010 (after the Balance Sheet date). The loss was also not covered by any insurance policy. Accordingly, full provision for bad debts amounting ₹3,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March, 2010.

## Question 16

Cashier of A-One Limited embezzled cash amounting to ₹6,00,000 during March, 2012. However same comes to the notice of the company management during April, 2012 only. Financial Statements of the company is not yet approved by the Board of Directors of the company. With the help of provisions AS 4 "Contingencies and events occurring after the Balance Sheet Date" decide whether the embezzlement of cash should be adjusted in the books of accounts for the year ending March, 2012?

What will be your reply, if embezzlement of cash comes to the notice of company management only after approval of financial statements by the Board of Directors of the company?

(*May 2012, 4 Marks*)

**Answer**

As per AS-4 'Contingencies and Events Occurring after the Balance Sheet Date' issued by the Council of the Institute of Chartered Accountants of India, Events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustments to assets and liabilities as at the balance sheet date or may require disclosure.

Adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

In the given case cash of ₹6,00,000 of A-One limited was embezzled during March 2012. However it came to the notice of management during April 2012 only. As the financial statements are not yet approved by the Board of directors of the company, embezzlement of cash should be adjusted in the books of accounts for the year ending March, 2012.

If embezzlement of cash comes to the notice of the management only after approval of financial statement by the board of directors, then it should not be adjusted or disclosed in the financial statements or books of accounts for the year ending March, 2012.

## Question 17

Neel Limited has its corporate office in Mumbai and sells its products to stockists all over India. On 31st March, 2013, the company wants to recognize receipt of cheques bearing date 31st March, 2013 or before, as "Cheques in Hand" by reducing "Trade Receivables". The "Cheques in Hand" is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques are presented to the bank in the month of April 2013 and are also realized in the same month in normal course after deposit in the bank. State with reasons, whether each of the following is an adjusting event and how this fact is to be disclosed by the company, with reference to the relevant accounting standard.

(i) Cheques collected by the marketing personnel of the company from the stockists on or before 31st March, 2013.

(ii) Cheques sent by the stockists through courier on or before 31st March, 2013.

(*May 2013, 4 Marks*)

**Answer**

| *Nature of Transaction on the date of Balance Sheet (31st March, 2013* | *Treatment in the Books of Accounts* |
|---|---|
| Cheques collected by the marketing personnel of the company from the stockists on or before 31st March, 2013. | In this case, the company has collected the amount before 31st March through its Marketing Personnel. Marketing Personnel being employees of the company, the collection of cheques constitutes a *"receipt"* by the company, before the Balance Sheet date. Subsequent realization in April provides additional evidence of the matter, and hence the Company can consider this as an "*Adjusting Event"* and account for such items as "*Cheques in Hand".* |
| Cheques sent by the stockists through courier on or before 31st March, 2013. | In this case, the Company has not *"received"* the Cheques before 31st March, 2013. Hence, mere sending of the cheques by the Stockists through Courier can not be treated as receipt on the Balance Sheet date. Therefore, this amount should not be adjusted in the accounts. |

## Question 18

State with reasons, how the following events would be dealt with in the financial statements of Pradeep Ltd. for the year ended 31st March, 2013:

(i) An agreement to sell a land for ₹ 30 lakh to another company was entered into on 1st March, 2013. The value of land is shown at ₹ 20 lakh in the Balance Sheet as on 31st March, 2012. However, the Sale Deed was registered on 15th April, 2013.

(ii) The negotiation with another company for acquisition of its business was started on 2nd February, 2013. Pradeep Ltd. invested ₹ 40 lakh on 12th April, 2013.

(*November 2013, 5 Marks*)

**Answer**

As per AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In the instant case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 1st March, 2013 i.e. before the balance sheet date. Registration of the sale deed on 15th April, 2013, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of land is necessary in the financial statements of Pradeep Ltd. for the year ended 31st March, 2013.

As per AS 4 (Revised) "Events occurring after the balance sheet date" are the significant events (both favorable and unfavorable) that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 2013.

Applying provisions of this standard clearly state that/disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 40 lakhs in April, 2013 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

## Question 19

With reference to AS-4 "Contingencies and events occurring after the balance sheet date", state whether the following events will be treated as contingencies, adjusting events or non-adjusting events occurring after balance sheet in case of a company which follows April to March as its financial year.

(i) A major fire has damaged the assets in a factory on 5th April, 5 days after the year end. However, the assets are fully insured and the books have not been approved by the Directors.

(ii) A suit against the company's advertisement was filed by a party on 10th April, 10 days after the year end claiming damages of ₹ 20 lakhs.

(iii) It sends a proposal to purchase an immovable property for ₹ 30 lakhs in March. The book value of the property is ₹ 20 lakhs as on year end date. However, the deed was registered as on 15th April.

(iv) The terms and conditions for acquisition of business of another company have been decided by March end. But the financial resources were arranged in April and amount invested was ₹ 40 lakhs.

(v) Theft of cash of ₹ 2 lakhs by the cashier on 31st March but was detected the next day after the financial statements have been approved by the Directors.

(*May 2016, 5 Marks*)

**Answer**

According to AS 4 on 'Contingencies and Events Occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. However, adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. "Contingencies" used in the Standard is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur.

**(i)** Fire has occurred after the balance sheet date and also the loss is totally insured. Therefore, the event becomes immaterial and the event is **non-adjusting** in nature.

**(ii)** The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of ₹ 20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a **non-adjusting** event.

**(iii)** In the given case, proposal for deal of immovable property was sent before the closure of the books of accounts. This is a **non-adjusting** event as only the proposal was sent and no agreement was effected in the month of March i.e. before the balance sheet date.

**(iv)** As the term and conditions of acquisition of business of another company had been decided by the end of March, acquisition of business is an **adjusting event** occurring after the balance sheet date. Adjustment to assets and liabilities is required since the event affects the determination and the condition of the amounts stated in the financial statements for the financial year ended on 31st March.

**(v)** Since the financial statements have been approved before detection of theft by the cashier of ₹ 2,00,000, it becomes a **non-adjusting** event and no disclosure is required in the report of the Approving Authority.

## Question 20

While preparing its final accounts for the year ended 31st March, 2016, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2016 a debtor for ₹20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2016 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2016?

Comment with reference to relevant Accounting Standard. (*November, 2016, 5 Marks*)

**Answer**

As per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustment to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

A debtor for ₹ 20,00,000 suffered heavy loss due to earthquake in the last week of February, 2016 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in April, 2016 (after the balance sheet date) is only an additional information related to the condition existing on the balance sheet date. However, bankruptcy of debtors is an adjusting event.

Accordingly, full provision for bad debts amounting ₹ 20,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2016. Since the company has already made 5% provision of its total debtors, additional provision amounting ₹ 19,00,000 shall be made (20,00,000 x 95%).

## Question 21

The accounting year of Dee Limited ended on 31st March, 2018 but the accounts were approved on 30th April, 2018. On 15th April, 2018 a fire occurred in the factory and office premises. The loss by fire is of such a magnitude that it was not possible to expect the enterprise Dee Limited to start operation again.

State with reasons, whether the loss due to fire is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company in the context of the provisions of AS-4 (Revised).

(*November 2018*) (*5 Marks*)

**Answer:**

As per AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date", an event occurring after the balance sheet date should be an adjusting event even if it does not reflect any condition existing on the balance sheet date, if the event is such as to indicate that the fundamental accounting assumption of going concern is no longer appropriate.

The fire occurred in the factory and office premises of an enterprise after 31 March, 2018 but before approval of financial statement of 30.4.18. The loss by fire is of such a magnitude that it is not reasonable to expect the Dee Ltd. to start operations again, i.e., the going concern assumption is not valid. Since the fire occurred after 31/03/18, the loss on fire is not a result of any condition existing on 31/03/18. But the loss due to fire is an adjusting event the entire accounts need to be prepared on a liquidation basis with adequate disclosures by the company by way of note in its financial statements in the following manner:

"Major fire occurred in the factory and office premises on 15th April, 2018 which has made impossible for the enterprise to start operations again. Therefore, the financial statements have been prepared on liquidation basis."

## Question 22

The Board of Directors of New Graphics Ltd. in its Board Meeting held on 18th April, 2017, considered and approved the Audited Financial results along with Auditors Report for the Financial Year ended 31st March, 2017 and recommended a dividend of ₹2 per equity share (on 2 crore fully paid up equity shares of ₹10 each) for the year ended31st March, 2017 and if approved by the members at the forthcoming Annual General Meeting of the company on 18th June, 2017, the same will be paid to all the eligible shareholders.

Discuss on the accounting treatment and presentation of the said proposed dividend in the annual accounts of the company for the year ended 31st March, 2017 as per the applicable Accounting Standard and other Statutory Requirements.

(*RTP May 2019*)

**Answer:**

As per the amendment in AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" vide Companies (Accounting Standards) Amendments Rules, 2016 dated 30th March, 2016, the events which take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature.

However, dividends declared after the balance sheet date but before approval of financial statements are not recognized as a liability at the balance sheet date because no statutory obligation exists at that time. Hence such dividends are disclosed in the notes to financial statements.

No, provision for proposed dividends is not required to be made. Such proposed dividends are to be disclosed in the notes to financial statements. Accordingly, the dividend of ₹4 crores recommended by New Graphics Ltd. in its Board meeting on 18th April, 2017 shall not be accounted for in the books for the year 2016-17 irrespective of the fact that it pertains to the year 2016-17 and will be paid after approval in the Annual General Meeting of the members/shareholders.

## Question 23

While preparing its final accounts for the year ended 31st March, 2017, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2017 a debtor for ₹20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2017 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2017? You are required to advise the company in line with AS 4.

(*RTP November 2018*)

**Answer:**

As per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustment to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

A debtor for ₹20,00,000 suffered heavy loss due to earthquake in the last week of February, 2017 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in April, 2017 (after the balance sheet date) is only an additional information related to the condition existing on the balance sheet date.

Accordingly, full provision for bad debts amounting ₹20,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2017. Since the company has already made 5% provision of its total debtors, additional provision amounting ₹19,00,000 shall be made (20,00,000 × 95%) for the year ended 31st March, 2017.

## Question 24

With reference to AS 4 "Contingencies and events occurring after the balance sheet date", identify whether the following events will be treated as contingencies, adjusting events or non-adjusting events occurring after balance sheet date in case of a company which follows April to March as its financial year.

(i) A major fire has damaged the assets in a factory on 5th April, 5 days after the year end. However, the assets are fully insured and the books have not been approved by the Directors.

(ii) A suit against the company's advertisement was filed by a party on 10th April, 10 days after the year end claiming damages of ₹20 lakhs.

(*RTP May 2018*)

**Answer:**

According to AS 4 on 'Contingencies and Events Occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. However, adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. "Contingencies" used in the Standard is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur.

(i) Fire has occurred after the balance sheet date and also the loss is totally insured. Therefore, the event becomes immaterial and the event is non-adjusting in nature.

(ii) The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of ₹20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a non-adjusting event.

## Question 25

While preparing its final accounts for the year ended 31st March, 2016, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2016 a debtor for ₹20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2016 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2016?

Comment with reference to relevant Accounting Standard.

(*MTP March 2019*) (*5 Marks*)

**Answer:**

As per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustment to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

A debtor for ₹20,00,000 suffered heavy loss due to earthquake in the last week of February, 2016 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in April, 2016 (after the balance sheet date) is only an additional information related to the condition existing on the balance sheet date.

Accordingly, full provision for bad debts amounting ₹20,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2016. Since the company has already made 5% provision of its total debtors, additional provision amounting ₹19,00,000 shall be made (20,00,000 x 95%).

## Question 26

Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31 March 2020 are to be approved by the approving authority on 30 June 2020. During the first quarter of 2020-2021, the following events/transactions has taken place. The accountant of the company seeks your guidance for the following:

(i) Tee Ltd. has an inventory of 50 stitching machines costing at ₹ 5,500 per machine as on 31 March 2020. On 31 March 2020 the company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realisable value, whichever is lower. During the month of April 2020, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during this month at a price of ₹ 4,000 per machine.

(ii) A fire has broken out in the company's godown on 15 April 2020. The company has estimated a loss of ₹ 25 lakhs of which 75% is recoverable from the Insurance company.

(iii) The company has entered into a sale agreement on 30 March 2020 to sell a property for a consideration of ₹ 7,50,000 which is being carried in the books at ₹ 5,50,000 at the year end. The transfer of risk and reward and sale is complete in the month of May 2020 when conveyance and possession get completed.

(iv) The company has received, during the year 2018-2019, a government grant of ₹ 15 lakhs for purchase of a machine. The company has received a notice for refund of the said grant on 15 June, 2020 due to violation of some of the conditions of grant during the year 2019-2020.

You are required to state with reasons, how the above transactions will be dealt with in the financial statement for the year ended 31st March 2020.

(*MTP*, *October 2021*) (*5 Marks*)

**Answer**

Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and by the corresponding approving authority in the case of any other entity.

Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern is not appropriate.

In the given case, financial statements are approved by the approving authority on 30 June 2020.

On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:

(i) Since on 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an adjusting event. Hence, Tee Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realisable value at the end of the reporting period. Accordingly, inventory should be written down to ₹ 4,000 per machine. Total value of inventory in the books will be 50 machines x ₹ 4,000 = ₹ 2,00,000.

(ii) A fire took place after the balance sheet date i.e. during 2020 -2021 financial year. Hence, corresponding financials of 2019-2020 financial year should not be adjusted for loss occurred due to fire. However, in this circumstance, the going concern assumption will be evaluated. In case the going concern assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements. Otherwise, disclosure be given.

(iii) Since the transfer of risk and reward and sale was complete in the month of May, 2020 when conveyance and possession got complete, no revenue should be recognised with respect to it in the financial statements of 2019-2020. However, a disclosure for the same should be given by the entity.

(iv) Since the notice has been received after 31 March but before 30 June 2020 (approval date), the said grant shall be adjusted in the financial statements for financial year 2019 -2020 because the violation of the conditions took place in the financial year 2019 -2020 and the company must be aware of it.

## Question 27

XYZ Ltd. operates its business into various segments. Its financial year ended on 31st March, 2020 and the financial statements were approved by their approving authority on 15th June, 2020. The following material events took place:

(a) A major property was sold (it was included in the balance sheet at ₹ 25,00,000) for which contracts had been exchanged on 15th March, 2020. The sale was completed on 15th May, 2020 at a price of ₹ 26,50,000.

(b) On 2nd April, 2020, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of ₹ 10 million would be fully covered by the insurance company.

(c) A claim for damage amounting to ₹ 8 million for breach of patent had been received by the entity prior to the year-end. It is the director's opinion, backed by legal advice that the claim will ultimately prove to be baseless. But it is still estimated that it would involve a considerable expenditure on legal fees.

You are required to state with reasons, how each of the above items should be dealt with in the financial statements of XYZ Ltd. for the year ended 31st March, 2020.

(*RTP November 2021*)

**Answer**

**Treatment as per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date'**

(a) The sale of property should be treated as an adjusting event since contracts had been exchanged prior to the year-end. The effect of the sale should be reflected in the financial statements ended on 31.3.2020 and the profit on sale of property ₹ 1,50,000 would be considered.

(b) The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover. Also, since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.

(c) On the basis of evidence provided, the claim against the company will not succeed. Thus, ₹ 8 million should not be provided in the account, but should be disclosed by means of a contingent liability with full details of the facts. Provision should be made for legal fee expected to be incurred to the extent that they are not expected to be recovered.

## Question 28

Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31st March 2020 are to be approved by the approving authority on 30th June 2020. During the first quarter of 2020-2021, the following events / transactions has taken place. The accountant of the company seeks your guidance for the following:

(i) Tee Ltd. has an inventory of 50 stitching machines costing at ₹ 5,500 per machine as on 31st March 2020. The company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realizable value, whichever is lower. During the month of April 2020, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during April, 2020 at a price of ₹ 4,000 per machine.

(ii) A fire has broken out in the company's godown on 15th April 2020. The company has estimated a loss of ₹ 25 lakhs of which 75% is recoverable from the Insurance company.

(iii) A suit against the company's advertisement was filed by a party on 10th April, 2020 10 days after the year end claiming damages of ₹ 20 lakhs.

You are required to state with reasons, how the above transactions will be dealt with in the financial statements for the year ended 31 March 2020.

(*RTP May, 2022*)

**Answer**

Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity. Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern is not appropriate. In the given case, financial statements are approved by the approving authority on 30 June 2020. On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:

(i) Since on 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an adjusting event. Hence, Tee Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realizable value at the end of the reporting period. Accordingly, inventory should be written down to ₹ 4,000 per machine. Total value of inventory in the books will be 50 machines x ₹ 4,000 = ₹ 2,00,000.

(ii) A fire took place after the balance sheet date i.e. during 2020-2021 financial year. Hence, the financial statements for the year 2019-2020 should not be adjusted for loss occurred due to fire. However, in this circumstance, the going concern assumption will be evaluated. In case the going concern assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements.

(iii) The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of ₹ 20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a non-adjusting event.

## Question 29

As per the provision of AS 4, you are required to state with reason whether the following transactions are adjusting event or non-adjusting event for the year ended 31.03.2021 in the. books of NEW Ltd. (accounts of the company were approved by board of directors on 10.07.2021):

1. Equity Dividend for the year 2020-21 was declared at the rate of 7% on 15.05.2021.
2. On 05.03.2021, ₹ 53,000 cash was collected from a customer but not deposited by the cashier. This fraud was detected on 22.06.2021.

3. One Building got damaged due to occurrence of fire on 23.05.2021. Loss was estimated to be ₹ 81,00,000.

(*Question Paper of December 2021*) (*5 Marks*)

**Answer:**

(i) If dividends are declared after the balance sheet date but before the financial statements are approved, the dividends are not recognized as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise. Such dividends are disclosed in the notes. Thus, no liability for dividends needs to be recognized in financial statements for financial year ended 31st March, 2021 and declaration of dividend is non-adjusting event.

(ii) As per AS 4 'Contingencies and Events occurring after the Balance Sheet Date' an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes if such events relate to conditions existing at the balance sheet date. In the given case, fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognize the loss. Thus loss amounting ₹ 53,000 should be adjusted in the accounts of the company for the year ended 31st March, 2021 as it is adjusting event.

(iii) AS 4 states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The damage of one building due to fire did not exist on the balance sheet date i.e. 31.3.2021. Therefore, loss occurred due to fire is not to be recognized in the financial year 2020-2021 as it is non-adjusting event.

However, according to the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the fire has caused major destruction; therefore, fundamental accounting assumption of going concern would have to be evaluated. Considering that the going concern assumption is still valid, the fact of fire together with an estimated loss of ₹ 81 lakhs should be disclosed in the report of the approving authority for financial year 2020 -21 to enable users of financial statements to make proper evaluations and decisions.

## Question 30

Explain accounting treatment of Contingent Gains as per AS 4 "Contingencies and Events occurring after the Balance Sheet Date".

(*RTP November, 2022*)

**Answer**

**Accounting Treatment of Contingent Gains**

Contingent gains are not recognised in financial statements since their recognition may result in the recognition of revenue which may never be realised. However, when the realisation of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate.

CHAPTER

# 18

# Accounting Standard 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

## Question 1

*From the past 5 financial years, an old outstanding balance of ₹50,000 was still appearing as sundry creditor in the current year balance sheet of People Ltd. The company is certain that this amount is not payable due to one or more reasons. Therefore, it decided to write off the said amount in its current year's books of accounts and recognize it as income. The company treated the amount of ₹ 50,000 written off as a prior period item and made the adjustments accordingly.*

*The company is of the view that since sundry balances were recognized in the prior period(s), its related written-off amount should be treated as a prior period item.*

(*Source: Illustration 1, Study Material*)

**Answer**

No, the company is not correct in treating the amount written off as a prior period item. As per AS 5, prior period items are income or expenses which arise in a current year due to errors or omissions in the preparation of the financial statements of one or more prior period(s).

Writing off an old outstanding balance in the current year which is appearing in its books of accounts from the past 5 financial years does not mean that there has been an error or omission in the preparation of financial statements of prior period(s). It is just a practice adopted by the company to write off the old outstanding balances of more than 5 years in its current year books of accounts. Therefore, the amount written off is not treated as a prior period item.

Hence, adjusting the amount ₹50,000 written off as a prior period item on the basis that sundry balances were recognized in prior period(s) is not in line with AS 5.

## Question 2

*Fuel surcharge is billed by the State Electricity Board at provisional rates. Final bill for fuel surcharge of ₹ 5.30 lakhs for the period October, 20X1 to September, 20X7 has been received and paid in February, 20X8. However, the same was accounted in the year 20X8-X9. Comment on the accounting treatment done in the said case.*

(*Source: Illustration 2, Study Material*)

**Answer**

The final bill having been paid in February, 20X8 should have been accounted for in the annual accounts of the company for the year ended 31st March, 20 X8. However, it seems that as a result of error or omission in the preparation of the financial statements of prior period i.e., for the year ended 31st March 20X8, this material charge has arisen in the current period i.e., year ended 31st March, 20X9. Therefore, it should be treated as 'Prior period item' as per AS 5. As per AS 5, prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

It may be mentioned that it is an expense arising from the ordinary course of business. Although abnormal in amount or infrequent in occurrence, such an expense does not qualify an extraordinary item as per AS 5. For better understanding, the fact that power bill is accounted for at provisional rates billed by the state electricity board and final adjustment thereof is made as and when final bill is received may be mentioned as an accounting policy.

## Question 3

*(i)* *During the year 20X1-20X2, a medium size manufacturing company wrote down its inventories to net realisable value by ₹ 5,00,000. Is a separate disclosure necessary?*

*(ii)* *A company signed an agreement with the Employees Union on 1.9.20 X2 for revision of wages with retrospective effect from 30.9.20X1. This would cost the company an additional liability of ₹ 5,00,000 per annum. Is a disclosure necessary for the amount paid in 20X2-X3?*

(*Source: Illustration 3, Study Material*)

**Answer**

(i) Although the case under consideration does not relate to extraordinary item, but the nature and amount of such item may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' states that:

"When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately."

Circumstances which may require separate disclosure of items of income and expense in accordance with AS 5 include the write-down of inventories to net realisable value as well as the reversal of such write-downs.

(ii) It is given that revision of wages took place on 1st September, 20X2 with retrospective effect from 30.9.20X1. Therefore wages payable for the half year from 1.10.20X2 to 31.3.20X3 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. Additional wages liability of ₹ 7,50,000 (for 1½ years @ ₹ 5,00,000 per annum) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Such an expense does not qualify as an extraordinary item. However, as per AS 5, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

## Question 4

*The company finds that the inventory sheets of 31.3.20X1 did not include two pages containing details of inventory worth ₹ 14.5 lakhs. State, how you will deal with the following matters in the accounts of Omega Ltd. for the year ended 31st March, 20X2.*

(*Source: Illustration 4, Study Material*)

**Answer**

AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', defines Prior Period items as "income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods".

Rectification of error in inventory valuation is a prior period item vide AS 5. Separate disclosure of this item as a prior period item is required as per AS 5.

## Question 5

*Explain whether the following will constitute a change in accounting policy or not as per AS 5.*

*(i)* *Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement.*

*(ii)* *Management decided to pay pension to those employees who have retired after completing 5 years of service in the organisation. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organisation.*

(*Source: Illustration 5, Study Material*)

**Answer**

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

(i) Accordingly, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy.

(ii) Similarly, the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial will not be treated as a change in an accounting policy.

## Question 6

*In the current year, A Ltd. changed the depreciation method from the Straight Line Method (SLM) to Written Down Value (WDV) method. When A Ltd. recomputed depreciation retrospectively as per the new method, deficiency arose in depreciation in respect of past years. Therefore, it reduced the carrying amount of the asset by the amount of deficiency and such change in carrying amount (deficiency amount) has been debited to the statement of profit and loss as an extraordinary expense.*

*Whether the change in the carrying amount of assets due to the change in depreciation method should be treated as an extraordinary item?*

(*Source: Illustration 6, Study Material*)

**Answer**

No.

As per AS 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

A change in the method of charging depreciation is not an event that is clearly distinct from the ordinary activities of the entity. In the instant case, A Ltd. has changed the depreciation method and treated the reduction in carrying amount (or amount of deficiency in depreciation) of the asset as an extraordinary expense. This is not correct. Such deficiency should be treated as a normal expense.

A change in the estimated useful life of a depreciable asset (i.e. change in depreciation method) affects the depreciation in the current period and in each period during the remaining useful life of the asset. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods, is recognised in future periods.

The change in depreciation method is considered as a change in accounting estimate as per the provisions of AS 5.

## Question 7

*A company (Z Ltd.) is engaged in the business of providing consultancy services. A few days back, it received a notice from GST department raising a demand of GST on consultancy services provided by it for Rs. 500,000. Recently Z Ltd. paid the demand. In the books, the payment is recorded as an extraordinary expenditure.*

*Whether payment of tax demand raised by the taxation authority can be recognised as an extraordinary item?*

**Answer**

No payment of tax cannot be recognised as an extraordinary item.

As per AS 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" an extraordinary item is income or expenses that arise from events or transactions that are clearly distinct from ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

In the given case, providing consultancy service is an ordinary activity of Z Ltd. Thus, GST paid pursuant to the demand raised by GST department is also a part of an ordinary activity of Z Ltd. Recognising such payments as an extra-ordinary item is contrary to AS 5.

# QUESTION BANK

## Question 8

As per the provisions of AS-5, extraordinary items should not be disclosed in the statement of profit and loss as a part of net profit or loss for the period.

(*May 2019*) (*1 Marks*)

**Answer**

**False:** The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

## Question 9

PQR Ltd. is in the process of finalizing its accounts for the year ended 31st March, 2018. The company seeks your advice on the following:

(i) Goods worth ₹5,00,000 were destroyed due to flood in September, 2015. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2015-16. In March, 2018, the claim was passed and the company received a payment of ₹3,50,000 against the claim. Explain the treatment of such receipt in final account for the year ended 31st March, 2018.

(ii) Company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2017-18.

Subsequently, on a review of the credit period allowed and financial capacity of the customers, the company decides to increase the provision to 8% on debtors as on 31.03.2018. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard, can this revision be considered as an extra ordinary item or prior period item?

(*May 2018*) (*5 Marks*)

**Answer:**

(i) As per the provisions of AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", *prior period items* are income or expenses, which arise, in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. Further, the nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on current profit or loss can be perceived.

In the given instance, it is clearly a case of error/omission in preparation of financial statements for the year 2015-16. Hence, claim received in the financial year 2017-18 is a prior period item and should be separately disclosed in the statement of Profit and Loss.

(ii) In the given case, a limited company created 2.5% provision for doubtful debts for the year 2017-2018. Subsequently, the company revised the estimates based on the changed circumstances and wants to create 8% provision.

As per AS 5, the revision in rate of provision for doubtful debts will be considered as change in estimate and is neither a prior period item nor an extraordinary item.

The effect of such change should be shown in the profit and loss account for the year ending 31st March, 2018.

## Question 10

The Accountant of Mobile Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2017. You are required to advise him in the following situations in accordance with the provisions of AS 5

(i) Provision for doubtful debts was created @ 2% till 31st March, 2016. From the Financial year 2016-2017, the rate of provision has been changed to 3%.

(ii) During the year ended 31st March, 2017, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.

(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹20,000 per month. Earlier there was no such scheme of pension in the organization.

(v) During the year ended 31st March, 2017, there was change in cost formula in measuring the cost of inventories.

(*RTP November 2018*)

**Answer:**

(i) In the given case, Mobile limited created 2% provision for doubtful debts till 31st March, 2016. Subsequently in 2016-17, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in an accounting policy.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

## Question 11

Bela Ltd. has a vacant land measuring 20,000 sq. mts, which it had no intention to use in the future. The Company decided to sell the land to tide over its liquidity problems and made a profit of ₹10 Lakhs by selling the said land. Moreover, there was a fire in the factory and a part of the unused factory shed valued at ₹8 Lakhs was destroyed. The loss from fire was set off against the profit from sale of land and profit of ₹2 lakhs was disclosed as net profit from sale of assets.

You are required to examine the treatment and disclosure done by the company and advise the company in line with AS 5.

(*RTP May 2018*)

**Answer:**

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

In the given case the selling of land to tide over liquidation problems as well as fire in the Factory does not constitute ordinary activities of the Company. These items are distinct from the ordinary activities of the business. Both the events are material in nature and expected not to recur frequently or regularly. Thus, these are Extraordinary Items.

Therefore, in the given case, disclosing net profits by setting off fire losses against profit from sale of land is not correct. The profit on sale of land, and loss due to fire should be disclosed separately in the statement of profit and loss.

## Question 12

Examine whether the following will constitute a change in accounting policy or not as per AS 5.

(i) Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement.

(ii) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organisation. Such employees will get pension of ₹20,000 per month. Earlier there was no such scheme of pension in the organisation.

(*MTP March 2019*) (*5 Marks*)

**Answer:**

As per AS 5 ‘Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies’, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

(i) Accordingly, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy.

(ii) Similarly, the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial will not be treated as a change in an accounting policy.

## Question 13

The Accountant of a company has sought your opinion with relevant reasons, whether the following will be treated as change in Accounting Policy or not for the year ended 31st March, 2020. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

(i) Provision for doubtful debts was created @ 2% till 31st March, 2019. From the Financial year 2019-2020, the rate of provision has been changed to 3%.

(ii) During the year ended 31st March, 2020, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.

(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.

(v) During the year ended 31st March, 2020, there was change in cost formula in measuring the cost of inventories.

(*MTP, May, 2020*) (*5 marks*)

**Answer:**

(i) In the given case, company has created 2% provision for doubtful debts till 31st March, 2019. Subsequently in 2019-20, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in an accounting policy.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

## Question 14

A company created a provision of ₹ 7,50,000 for staff welfare while preparing the financial statements for the year *2020-21*. On 31st March 2021, in a meeting with staff welfare association, it was decided to increase the amount of provision for staff welfare to ₹ 10,00,000. The accounts were approved by Board of Directors on 15th April, 2021.

You are required to explain the treatment of such revision in financial statements for the year ended 31st March 2021 in line with the provisions of AS 5?

(*MTP, March, 2021*) (*5 marks*)

**Answer**

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the change in amount of staff welfare provision amounting ₹ 2,50,000 is neither a prior period item nor an extraordinary item. It is a change in estimate, which has been occurred in the year 2020-21.

As per the provisions of the standard, normally, all items of income and expense which are recognized in a period are included in the determination of the net profit or loss for the period. This includes extraordinary items and the effects of changes in accounting estimates. However, the effect of such change in accounting estimate should be classified using the same classification in the statement of profit and loss, as was used previously, for the estimate.

## Question 15

S.T.B. Ltd. makes provision for expenses amounting ₹ 7,00,000 as on March 31, 2020, but the actual expenses during the year ending March 31, 2021 comes to ₹ 9,00,000 against provision made during the last year. State with reasons whether difference of ₹ 2,00,000 is to be treated as prior period item as per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

(*MTP, April, 2021*) (*5 marks*)

**Answer**

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', as a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. Estimates may have to be revised, if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.

As per the standard, the effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. Thus, revision of an estimate by its nature i.e. the difference of ₹ 2 lakhs, is not a prior period item. Therefore, in the given case expenses amounting ₹ 2,00,000 (i.e. ₹ 9,00,000 – ₹ 7,00,000) recorded in the current year, should not be regarded as prior period item.

## Question 16

State whether the following items are examples of change in Accounting Policy/Change in Accounting Estimates / Extraordinary items / Prior period items / Ordinary Activity :

(i) Actual bad debts turning out to be more than provisions.

(ii) Change from Cost model to Revaluation model for measurement of carrying amount of PPE.

(iii) Government grant receivable as compensation for expenses incurred in previous accounting period.

(iv) Treating operating lease as finance lease.

(v) Capitalisation of borrowing cost on working capital.

(vi) Legislative changes having long term retrospective application.

(vii) Change in the method of depreciation from straight line to WDV.

(viii) Government grant becoming refundable.

(ix) Applying 10% depreciation instead of 15% on furniture.

(x) Change in useful life of fixed assets.

(*Suggested, January, 2021*) (*5 marks*)

**Answer**

**Classification of given items is as follows:**

| Sr. No. | Particulars | Remarks |
|---|---|---|
| (i) | Actual bad debts turning out to be more than provisions | Change in Accounting Estimates |
| (ii) | Change from Cost model to Revaluation model for measurement of carrying amount of PPE | Change in Accounting Policy |
| (iii) | Government grant receivable as compensation for expenses incurred in previous accounting period | Extra-ordinary Items |
| (iv) | Treating operating lease as finance lease. | Prior- period Items |
| (v) | Capitalisation of borrowing cost on working capital | Prior-period Items (as interest on working capital loans is not eligible for capitalization) |
| (vi) | Legislative changes having long-term retrospective application | Ordinary Activity |
| (vii) | Change in the method of depreciation from straight line to WDV | Change in Accounting Estimates |
| (viii) | Government grant becoming refundable | Extra-ordinary Items |
| (ix) | Applying 10% depreciation instead of 15% on furniture | Prior- period Items |
| (x) | Change in useful life of fixed assets | Change in Accounting Estimates |

## Question 17

(a) There was a major theft of stores valued at ₹ 10 lakhs in the preceding year which was detected only during current financial year (2020-2021). How will you deal with this information in preparing the financial statements of R Ltd. for the year ended 31st March, 2021.

(b) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organisation. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization. Explain whether this will constitute a change in accounting policy or not as per AS 5.

(*RTP November 2021*)

**Answer**

**(a)** Due to major theft of stores in the preceding year (2019-2020) which was detected only during the current financial year (2020–2021), there was overstatement of closing inventory of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year. The adjustments are required to be made in the current year as 'Prior Period Items' as per AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies. Accordingly, the adjustments relating to both opening inventory of the current year and profit brought forward from the previous year should be separately disclosed in the statement of profit and loss together with their nature and amount in a manner that their impact on the current profit or loss can be perceived. Alternatively, it may be assumed that in the preceding year, the value of inventory of stores as found out by physical verification of inventories was considered in the preparation of financial statements of the preceding year. In such a case, only the disclosure as to the theft and the resulting loss is required in the notes to the accounts for the current year i.e, year ended 31st March, 2021.

**(b)** As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Accordingly, the adoption of a new accounting policy of paying pension to retired employees is a policy for events or transactions which did not occur previously. Hence, it will not be treated as a change in an accounting policy.

## Question 18

The Accountant of Mobile Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2021. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

(i) Provision for doubtful debts was created @ 2% till 31st March, 2020. From the Financial year 2020-2021, the rate of provision has been changed to 3%.

(ii) During the year ended 31st March, 2021, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.

(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.

(v) During the year ended 31st March, 2021, there was change in cost formula in measuring the cost of inventories.

(*RTP May, 2022*)

**Answer**

(i) In the given case, Mobile limited created 2% provision for doubtful debts till 31st March, 2020. Subsequently in 2020-21, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in accounting estimate and is not a change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in accounting policy.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in accounting estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

## Question 19

*The Accountant of Shiva Limited had sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policies or change in Accounting Estimates for the year ended 31st March, 2021. Please advise him in the following situations in accordance with the provisions of AS 5:*

*(i) Provision for doubtful debts was created @3% till 31st March, 2020. From the Financial year 2020-2021, the rate of provision has been changed to 4%.*

*(ii) During the year ended 31st March, 2021, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.*

*(iii) Till 31st March, 2020 the furniture was depreciated on straight line basis over a period of 5 years. From the Financial year 2020-2021, the useful life of furniture has been changed to 3 years.*

*(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.*

*(v) During the year ended 31st March 2021, there was change in cost formula in measuring the cost of inventories.*

(*Suggested November, 2022*) (*5 Marks*)

**Answer**

(i) In the given case, company has created 3cer% provision for doubtful debts till 31st March, 2020. Subsequently from 1st April, 2020, the company revised the estimates based on the changed circumstances and wants to create 4% provision. Thus, change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous transaction, will neither be treated as change in an accounting policy nor change in accounting estimate.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in accounting estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is neither a change in accounting policy nor a change in accounting estimate.

Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

## Question 20

Bela Ltd. has a vacant land measuring 20,000 sq. mts, which it had no intention to use in the future. The company decided to sell the land to tide over its liquidity problems and made a profit of ₹10 Lakhs by selling the said land. Moreover, there was a fire in the factory and a part of the unused factory shed valued at ₹ 8 Lakhs was destroyed. The loss from fire was set off against the profit from sale of land and profit of ₹2 lakhs was disclosed as net profit from sale of assets. Do you agree with the treatment and disclosure? If not, state your views.

(*RTP November, 2022*)

**Answer**

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

In the given case the selling of land to tide over liquidation problems as well as fire in the factory does not constitute ordinary activities of the Company. These items are distinct from the ordinary activities of the business. Both the events are material in nature and expected not to recur frequently or regularly. Thus, these are Extraordinary Items.

Therefore, in the given case, disclosing net profits by setting off fire losses against profit from sale of land is not correct. The profit on sale of land, and loss due to fire should be disclosed separately in the statement of profit and loss.

## Question 21

State whether the following items are examples of change in Accounting Policy/Change in Accounting Estimates/ Extraordinary items/Prior period items/Ordinary Activity:

(i) Actual bad debts turning out to be more than provisions.
(ii) Change from Cost model to Revaluation model for measurement of carrying amount of PPE.
(iii) Government grant receivable as compensation for expenses incurred in previous accounting period.
(iv) Treating operating lease as finance lease.
(v) Capitalisation of borrowing cost on working capital.
(vi) Legislative changes having long term retrospective application.
(vii) Change in the method of depreciation from straight line to WDV.
(viii) Government grant becoming refundable.
(ix) Applying 10% depreciation instead of 15% on furniture.
(x) Change in useful life of fixed assets.

(*RTP May, 2023*)

**Answer**

**Classification of given items is as follows:**

| Sr. No. | Particulars | Remarks |
|---|---|---|
| (i) | Actual bad debts turning out to be more than provisions | Change in Accounting Estimates |
| (ii) | Change from Cost model to Revaluation model for measurement of carrying amount of PPE | Change in Accounting Policy |
| (iii) | Government grant receivable as compensation for expenses incurred in previous accounting period | Extra -ordinary Items |
| (iv) | Treating operating lease as finance lease. | Prior- period Items |
| (v) | Capitalisation of borrowing cost on working capital | Prior-period Items (as interest on working capital loans is not eligible for capitalization) |
| (vi) | Legislative changes having long term retrospective application | Ordinary Activity |
| (vii) | Change in the method of depreciation from straight line to WDV | Change in Accounting Estimates |
| (viii) | Government grant becoming refundable | Extra -ordinary Items |
| (ix) | Applying 10% depreciation instead of 15% on furniture | Prior- period Items |
| (x) | Change in useful life of fixed assets | Change in Accounting Estimates |

CHAPTER

# 19

# Accounting Standards 22 Accounting for Taxes on Income

## Question 1

*Rama Ltd., has provided the following information:*

| | ₹ |
|---|---:|
| *Depreciation as per accounting records* | *= 2,00,000* |
| *Depreciation as per income tax records* | *= 5,00,000* |
| *Unamortised preliminary expenses as per tax record* | *= 30,000* |

*There is adequate evidence of future profit sufficiency. How much net deferred tax asset/liability should be recognised as transition adjustment? Tax rate 50%.*

(*Source: Illustration 1, Study Material*)

**Answer**

**Table showing calculation of deferred tax asset / liability**

| Particulars | Amount | Timing differences | Deferred tax | Amount @ 50% |
|---|---:|---|---|---:|
| | ₹ | | | ₹ |
| Excess depreciation as per tax records (₹ 5,00,000 – ₹ 2,00,000) | 3,00,000 | Timing | Deferred tax liability | 1,50,000 |
| Unamortised preliminary expenses as per tax records | 30,000 | Timing | Deferred tax asset | (15,000) |
| Net deferred tax liability | | | | 1,35,000 |

## Question 2

*From the following details of A Ltd. for the year ended 31-03-20X1, calculate the deferred tax asset/ liability as per AS 22 and amount of tax to be debited to the Profit and Loss Account for the year.*

| ***Particulars*** | ₹ |
|---|---:|
| *Accounting Profit* | *6,00,000* |
| *Book Profit as per MAT* | *3,50,000* |
| *Profit as per Income Tax Act* | *60,000* |
| *Tax rate* | *20%* |
| *MAT rate* | *7.50%* |

(*Source: Illustration 2, Study Material*)

**Answer**

Tax as per accounting profit 6,00,000 × 20% = ₹ 1,20,000 Tax as per Income-tax Profit 60,000 × 20% = ₹ 12,000

Tax as per MAT 3,50,000 × 7.50% = ₹ 26,250

Tax expense= Current Tax +Deferred Tax

₹ 1,20,000 = ₹ 12,000+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-20X1

= ₹ 1,20,000 – ₹ 12,000 = ₹ 1,08,000

Amount of tax to be debited in Profit and Loss account for the year 31 -03-20X1 Current Tax + Deferred Tax liability + Excess of MAT over current tax

**= ₹ 12,000 + ₹ 1,08,000 + ₹ 14,250 (26,250 – 12,000)** = ₹ 1,34,250

## Question 3

*PQR Ltd.'s accounting year ends on 31st March. The company made a loss of ₹ 2,00,000 for the year ending 31.3.20X1. For the years ending 31.3.20X2 and 31.3.20X3, it made profits of ₹ 1,00,000 and ₹ 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.20X1, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the years ending 20X2 and 20X3 for tax purposes. Prepare a statement of Profit and Loss for the years ending 20X1, 20X2 and 20X3.*

(*Source: Illustration 3, Study Material*)

**Answer**

**Statement of Profit and Loss**

| | **31.3.20X1** ₹ | **31.3.20X2** ₹ | **31.3.20X3** ₹ |
|---|---|---|---|
| Profit (Loss) | (2,00,000) | 1,00,000 | 1,20,000 |
| *Less:* Current tax (20,000 x 40%) | | | (8,000) |
| Deferred tax: | | | |
| Tax effect of timing differences originating during the year (2,00,000 x 40%) | 80,000 | | |
| Tax effect of timing differences reversed/adjusted during the year (1,00,000 x 40%) | | (40,000) | (40,000) |
| Profit (Loss) After Tax Effect | (1,20,000) | 60,000 | 72,000 |

## Question 4

*Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognises revenue from these contracts on percentage of completion method for financial statements during 20X0-20X1, 20X1-20X2 and 20X2-20X3 for ₹ 11,00,000, ₹ 16,00,000 and ₹ 21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognised revenue of ₹ 7,00,000, ₹ 18,00,000 and ₹ 23,00,000 for the years 20X0-20X1, 20X1-20X2 and 20X2-20X3 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 20X0-20X1, 20X1- 20X2 and 20X2-20X3.*

(*Source: Illustration 4, Study Material*)

**Answer**

**Calculation of Deferred Tax Asset/Liability in Omega Limited**

| **Year** | **Accounting Income** | **Taxable Income** | **Timing Difference** | **Timing Difference (balance)** | **Deferred Tax** | **Deferred Tax Liability (balance)** |
|---|---|---|---|---|---|---|
| 20X0-20X1 | 11,00,000 | 7,00,000 | 4,00,000 | 4,00,000 | 1,40,000 | 1,40,000 |
| 20X1-20X2 | 16,00,000 | 18,00,000 | (2,00,000) | 2,00,000 | (70,000) | 70,000 |
| 20X2-20X3 | 21,00,000 | 23,00,000 | (2,00,000) | NIL | (70,000) | NIL |
| | 48,00,000 | 48,00,000 | | | | |

## Question 5

*Write short note on Timing differences and Permanent differences as per AS 22.*

**Answer**

In current practices, companies, in general, prepare books of accounts as per Companies Act, 2013 generating Accounting Profit/Loss and Income-tax Act, 1961 generating Taxable Profit/Loss. Accounting income and taxable income for a period are seldom the same. Permanent differences are those which arise in one period and do not reverse subsequently. For e.g., an income exempt from tax or an expense that is not allowable as a deduction for tax purposes. Timing differences are those which arise in one period and are capable of reversal in one or more subsequent periods. For e.g., Depreciation etc.

## Question 6

*Y Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference is INR 200 lakhs and INR 400 lakhs respectively which will result in a tax liability in year 1 and 2. From the third year it is expected that the timing difference would reverse each year by INR 10 lakhs. Assuming tax rate of 40%, find out the deferred tax liability at the end of the second year and any charge to the Profit and Loss account.*

**Answer**

As per AS 22, 'Accounting for Taxes on Income', deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognised to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income- tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognised in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of 200 lakhs timing difference due to depreciation, difference amounting 80 lakhs (10 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognised. However, for 120 lakhs (200 lakhs – ₹ 80 lakhs), deferred tax liability will be recognised for 48 lakhs (40% of 120 lakhs) in first year. In the second year, the entire amount of timing difference of ₹ 400 lakhs will reverse only after tax holiday period and hence, will be recognised in full. Deferred tax liability amounting 160 lakhs (40% of 400 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be 208 lakhs (48 lakhs + 160 lakhs).

## Question 7

*Ultra Ltd. has provided the following information: Depreciation as per accounting records =INR 4,00,000 Depreciation as per tax records =INR 10,00,000*

*Unamortized preliminary expenses as per tax record = INR 30,000*

*There is adequate evidence of future profit sufficiency. How much deferred tax asset/liability should be recognized as transition adjustment when the tax rate is 50%?*

**Answer**

**Calculation of difference between taxable income and accounting income**

| Particulars | Amount (₹ ) |
|---|---|
| Excess depreciation as per tax ₹ (10,00,000 – 4,00,000) | 6,00,000 |
| *Less*: Expenses unamortized in tax records | (30,000) |
| Timing difference | 5,70,000 |

Tax expense is more than the current tax due to timing difference.

Therefore deferred tax liability = 50% x 5,70,000 = 2,85,000

## Question 8

*Saras Ltd. closes its books as on 31st March 20X2. They have accrued*

*₹ 5,00,000 towards GST Liability for the month of March 20X2 by debiting their Profit and loss statement which is expected to be paid off by 21st April 20X2 . As per the provisions of Section 43B of the Income Tax Act, 1961 – Any expenditure of the nature mentioned in section 43B (e.g. taxes, duty, cess, fees, etc.) accrued in the statement of profit and loss on mercantile basis will be allowed for tax purposes in subsequent years on payment basis only. Assuming a Tax rate of 30% determine the Deferred Tax Asset/Liability as at 31st March 20X2.*

**Answer**

**Calculation of difference between taxable income and accounting income**

| **Particulars** | **Amount (₹)** |
|---|---|
| GST Liability debited in books | 5,00,000 |
| *Less*: GST Liability allowed under Income Tax Act (Section 43B) | Nil |
| Timing difference | 5,00,000 |

Tax expense is less than the current tax due to timing difference. Therefore, deferred tax Asset = 30% x 5,00,000 = 1,50,000

## Question 9

*ABC Company limited had an investment in Venture Capital amounting ₹ 10 Crores. Venture capital in turn had invested in the below portfolio companies (New Start- ups) on behalf of ABC Limited:*

| ***Portfolio Companies*** | ***Amount of investment (₹ in Crores)*** |
|---|---|
| *Oscar Limited* | *2* |
| *Zee Limited* | *3* |
| *Star Limited* | *4* |
| *Sony Limited* | *1* |
| *Total* | *10* |

*During the FY 2019-2020, Venture Capital had sold their investment in Star Limited and realised an amount of ₹ 8 Crores on sale of shares of star Limited and entire proceeds of ₹ 8 Crores have been transferred by Venture Capital to ABC Company Limited.*

*The accounts manager has received the following additional information from venture capital on 31.03.2020:*

*(1) 8 Crores has been deducted from the cost of investment and carrying amount of investment as at year end is 2 Crores.*

*(2) Company had to pay a capital gain tax @ 20% on the net sale consideration of ₹ 4 Crores.*

*(3) Due to COVID-19, the remaining start- ups (i.e. Oscar Limited, Zee Limited, and Sony Limited) are not performing well and will soon wind up their operations. Venture capital is monitoring the situation and if required they will provide an impairment loss in June 2020 Quarter.*

*You need to suggest the accounts manager what should be the correct accounting treatment as per AS 22 "Accounting for Taxes on Income".*

**Answer**

As company had to pay capital gain tax @ 20% on the net sale consideration as per income tax laws, the company has to recognise a current tax liability of 0.8 Crores computed as under:

| **Particulars** | **Amount (₹ in Crores)** |
|---|---|
| Sales Consideration | 8 |
| Cost of Investment | 4 |
| Net gain on Sale | 4 |
| Tax @ 20% | 0.8 |

As per AS 22, Timing differences are those differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.

| **Particulars** | **Amount (₹ in Crores)** | **Rationale** |
|---|---|---|
| Taxable Income | 4 | As per income tax laws |
| Accounting Income | Nil | As the same is deducted from the cost of investment |
| Timing Difference | 4 | |

As per AS 22, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

Since in current scenario, due to Covid 19 the portfolio companies are not performing well, thus the company may not have sufficient future taxable income which will reverse deferred tax assets. Therefore, the company should not recognise DTA of ₹ 0.8 Crores and company should recognise only current tax liability of ₹ 0.8 Crores.

# QUESTION BANK

## Question 10

Write short not on Timing difference and permanent Difference as per AS 22.

(*May 2019*) (*5 Marks*)

**Answer:**

Matching of taxes against revenue for a period poses special problems arising from the fact that in number of cases, taxable income maybe different from the accounting income. The divergence between taxable income may be different from the accounting income arises due to two main reasons: Firstly, there are differences between items of revenue and expenses as appearing in the statement of profit and loss and the items which are considered as revenue, expenses or deductions for tax purposes, known as Permanent Difference. Secondly, there are differences between the amount in respect of a particular item of revenue or expense as recognised in the statement of profit and loss and the corresponding amount which is recognised for the computation of taxable income, known as Timing Difference.

Permanent differences are the differences between taxable income and accounting income which arise in one accounting period and do not reverse subsequently. For example, an income exempt from tax or an expense that is not allowable as a deduction for tax purposes.

Timing differences are those differences between taxable income and accounting income which arise in one accounting period and are capable of reversal in one or more subsequent periods. For e.g., Depreciation, Bonus, etc.

## Question 11

Rohit Ltd. has provided the following information

| Particulars | ₹ |
|---|---|
| Depreciation as per accounting records | 2,50,000 |
| Depreciation as per tax records | 5,50,000 |
| Unamortised preliminary expenses as per tax record | 40,000 |

There is adequate evidence of future profit sufficiency. How much deferred tax assets/liability should be recognized as transition adjustment when the tax rate is 50%?

(*May 2018*) (*5 Marks*)

**Answer:**

**Table showing calculation of deferred tax asset/liability**

| Particulars | Amount ₹ | Timing difference | Deferred tax | Amount @ 50% ₹ |
|---|---|---|---|---|
| Excess depreciation as per tax records (₹5,50,000 - ₹2,50,000) | 3,00,000 | Timing | Deferred tax liability | 1,50,000 |
| Unamortised preliminary expenses as per tax records | 40,000 | Timing | Deferred tax asset | (20,000) |
| Net deferred tax liability | | | | 1,30,000 |

Net deferred tax liability amounting ₹1,30,000 should be recognized as transition adjustment.

## Question 12

Is it permissible not to recognize deferred tax liability on the ground that the Company expects that there will be losses both for accounting and tax purposes in near future? You are required to give advise to the company.

(*RTP May 2019*)

**Answer:**

The Company should provide for deferred tax liability on the timing differences irrespective for the fact that these timing differences will reverse in the period in which the Company expects to be in loss both from the accounting as well as tax point of view. It may, however, be added that the deferred tax liability recognized at the balance sheet date will give rise to future taxable income at the time of reversal thereof.

## Question 13

Beta Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference resulting in a tax liability in year 1 and 2 is ₹1,000 lakhs and ₹2,000 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by ₹50 lakhs. Assuming tax rate of 40%, you are required to compute to the deferred tax liability at the end of the second year and any charge to the Profit and Loss account.

(*RTP November 2018*)

**Answer:**

As per para 13 of Accounting Standard (AS) 22, Accounting for Taxes on Income", deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognized to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income-tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognized in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of ₹1,000 lakhs depreciation, timing difference amounting ₹400 lakhs (₹50 lakhs × 8 years) will reverse in the tax holiday period and therefore, should not be recognized. However, for ₹600 lakhs (₹1,000 lakhs - ₹400 lakhs), deferred tax liability will be recognized for ₹240 lakhs (40% of ₹600 lakhs) in first year. In the second year, the entire amount of timing difference of ₹2,000 lakhs will reverse only after tax holiday period and hence, will be recognized in full. Deferred tax liability amounting ₹800 lakhs (40% of ₹2,000 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be ₹1,040 lakhs (240 lakhs + 800 lakhs).

## Question 14

Gamma Limited is working on different projects which are likely to be completed within 3 years period. It recognizes revenue from these contracts on percentage of completion method for financial statements during 2014-2015, 2015-2016 and 2016-2017 for ₹11,00,000, ₹16,00,000 and ₹21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognized revenue of ₹7,00,000, ₹18,00,000 and ₹23,00,000 for the years 2014-2015, 2015-2016 and 2016-2017 respectively. Income-tax rate is 35%.

You are required to compute the amount of deferred tax asset/liability for the years 2014-2015, 2015-2016 and 2016-2017. Also describe how this amount of deferred tax asset/liability will be disclosed in the balance sheet of Omega Limited as per provisions of AS 22.

(*MTP March 2018 & 2019*) (*5 Marks*)

**Answer:**

**Gamma Limited**

**Calculation of Deferred Tax Asset/Liability**

| Year | Accounting Income | Taxable Income | Timing Difference (balance) | Deferred Tax Liability (balance) |
|---|---|---|---|---|
| 2014-2015 | 11,00,000 | 7,00,000 | 4,00,000 | 1,40,000 |
| 2015-2016 | 16,00,000 | 18,00,000 | 2,00,000 | 70,000 |
| 2016-2017 | 21,00,000 | 23,00,000 | NIL | NIL |
| | 48,00,000 | 48,00,000 | | |

As per AS 22, deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities. The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts.

## Question 15

The following particulars are stated in the Balance Sheet of PQR Ltd. as on 31.03.2018:

| | (₹ in lakh) |
|---|---|
| Deferred Tax Liability (Cr.) | 30.00 |
| Deferred Tax Assets (Dr.) | 15.00 |

The following transactions were reported during the year 2018-2019:

| | | |
|---|---|---|
| (i) | Tax Rate | 30% |
| | | (₹ in lakh) |
| (ii) | Depreciation as per books | 80.00 |
| | Depreciation for tax purposes | 70.00 |
| (iii) | Items disallowed in 2017-2018 and allowed for tax purposes in 2018-2019. | 10.00 |
| (iv) | Donations to Private Trust made in 2018-2019. | 10.00 |

There were no additions to Fixed Assets during the year.

You are required to show the impact of various items on Deferred Tax Assets and Deferred Tax Liability as on 31.03.2019.

**Answer**

**Impact of various items in terms of AS 22 deferred tax liability/deferred tax asset**

| ***Transactions*** | ***Analysis*** | ***Nature of difference*** | ***Effect*** | ***Amount*** |
|---|---|---|---|---|
| Difference in depreciation | Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years. | Responding timing difference | Reversal of DTL | ₹ (80-70) lakh × 30% = ₹3 lakh |

| ***Transactions*** | ***Analysis*** | ***Nature of difference*** | ***Effect*** | ***Amount*** |
|---|---|---|---|---|
| Disallowances, as per IT Act, of earlier years | Tax payable for the earlier year was higher on this account. | Responding timing difference | Reversal of DTA | ₹ 10 lakh × 30% = ₹ 3 lakh |
| Donation to private trusts | Not an allowable expenditure under IT Act. | Permanent difference | Not applicable | Not applicable |

## Question 16

(a) The following information is furnished in respect of Slate Ltd. for the year ending 31-3-2019:

(i) Depreciation as per books ₹ 2,80,000
Depreciation for tax purpose ₹ 1,90,000
The above depreciation does not include depreciation on new additions.

(ii) A new machinery purchased on 1.4.18 costing ₹ 1,20,000 on which 100% depreciation is allowed in the 1st year for tax purpose whereas Straight-line method is considered appropriate for accounting purpose with a life estimation of 4 years.

(iii) The company has made a profit of ₹ 6,40,000 before depreciation and taxes.

(iv) Corporate tax rate of 40%.

Prepare relevant extract of statement of Profit and Loss for the year ending 31-3-2019 and also show the effect of above items on deferred tax liability/asset as per AS 22.

(b) What are the disclosure requirements for deferred tax assets and deferred tax liabilities in the balance sheet as per AS 22?

(*RTP, May, 2021*)

**Answer**

**(a) Statement of Profit and Loss for the year ended 31st March, 2019 (Extract)**

| | | | ₹ |
|---|---|---|---|
| Profit before depreciation and taxes | | | 6,40,000 |
| *Less*: Depreciation for accounting purposes (2,80,000+30,000) | | | (3,10,000) |
| Profit before taxes | (A) | | 3,30,000 |
| *Less*: Tax expense | (B) | | |
| Current tax (W.N.1) (3,30,000 x 40%) | | 1,32,000 | |
| Deferred tax (W.N.2) | | NIL | (1,32,000) |
| Profit after tax | (A-B) | | 1,98,000 |

**Working Notes:**

**1. Computation of taxable income**

| | ***Amount (₹)*** |
|---|---|
| Profit before depreciation and tax | 6,40,000 |
| *Less:* Depreciation for tax purpose (1,90,000 + 1,20,000) | (3,10,000) |
| Taxable income | 3,30,000 |
| Tax on taxable income @ 40% | 1,32,000 |

**2. Impact of various items in terms of deferred tax liability / deferred tax asset**

| ***S. No.*** | ***Transactions*** | ***Analysis*** | ***Nature of difference*** | ***Effect*** | ***Amount (₹)*** |
|---|---|---|---|---|---|
| (i) | Difference in depreciation | Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years. | Responding timing difference | Reversal of DTL | (2,80,000 - 1,90,000) x 40% = (36,000) |
| (ii) | Depreciation on new machinery | Due to Allowance of full amount as expenditure under IT Act, tax payable in the earlier years is less. | Timing difference | Creation of DTL | (1,20,000 – 30,000) x 40% = 36,000 |
| | Net impact | | | | NIL |

**(b)** The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balance should be disclosed in the notes to accounts. Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities. The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

## Question 17

From the following details of Aditya Limited for accounting year ended on 31st March, 2020:

| Particulars | ₹ |
|---|---|
| Accounting profit | 15,00,000 |
| Book profit as per MAT | 7,50,000 |
| Profit as per Income tax Act | 2,50,000 |
| Tax Rate | 20% |
| MAT Rate | 7.5% |

Calculate the deferred tax asset/liability as per AS 22 and amount of tax to be debited to the profit and loss account for the year.

(*Suggested, November, 2020) (5 marks)*

**Answer**

Tax as per accounting profit 15,00,000×20%= ₹ 3,00,000 Tax as per

Income-tax Profit 2,50,000×20% =₹ 50,000

Tax as per MAT 7,50,000×7.50%= ₹ 56,250

Tax expense= Current Tax +Deferred Tax ₹ 3,00,000 = ₹ 50,000+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-2020

= ₹ 3,00,000 – ₹ 50,000 = ₹ 2,50,000

Amount of tax to be debited in Profit and Loss account for the year 31-03-2020

Current Tax + Deferred Tax liability + Excess of MAT over current tax

= ₹ 50,000 + ₹ 2,50,000 + ₹ 6,250 (56,250 – 50,000) = ₹ 3,06,250

## Question 18

The following particulars are stated in the Balance Sheet of HS Ltd. as on 31 -3-2019:

| Particulars | (₹ in lakhs) |
|---|---|
| Deferred Tax Liability (Cr.) | 60.00 |
| Deferred Tax Assets (Dr.) | 30.00 |
| The following transactions were reported during the year 2019-20: | |
| Depreciation as per accounting records | 160.00 |
| Depreciation as per income tax records | 140.00 |
| Items disallowed for tax purposes in 2018-19 but allowed in 2019-20 | 20.00 |
| Donation to Private Trust | 20.00 |
| Tax rate | 30% |

There were no additions to fixed assets during the year. You are required to show the impact of various items on Deferred Tax Assets and Deferred Tax Liability as on 31-3-2020 as per AS-22.

(*Suggested, January, 2021*) (*5 marks*)

**Answer**

Impact of various items in terms of AS 22 deferred tax liability/deferred tax asset

(1) Difference in Depreciation-Generally, written down value method of depreciation is adopted under income Tax Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years. It is timing difference for which reversal of Deferred tax liability is required.

Reversal of DTL= ₹ (160 – 140) Lakhs X 30% = ₹6 Lakhs

(2) Disallowances, as per IT Act of earlier years- Due to disallowance tax payable for the earlier years was higher on this account. It is responding timing difference which required Reversal of Deferred tax assets.

Reversal of Deferred tax assets = ₹20 Lakhs X 30% = ₹ 6 Lakhs

(3) Donations to private trusts is not an allowable expenditure under IT Act. It is permanent difference. Hence, no reversal of tax is required.

## Question 19

The following particulars are stated in the Balance Sheet of Deep Limited as on 31st March, 2020:

| | **(₹ In Lakhs)** |
|---|---|
| Deferred Tax Liability (Cr.) | 28.00 |
| Deferred Tax Assets (Dr.) | 14.00 |

The following transactions were reported during the year 2020 -2021:

(i) Depreciation as per books was ₹ 70 Lakhs whereas Depreciation for Tax purposes was ₹ 42 Lakhs. There were no additions to Fixed Assets during the year.

(ii) Expenses disallowed in 2019-20 and allowed for tax purposes in 2020-21 were ₹ 14 Lakhs.

(iii) Share issue expenses allowed under section 35(D) of the Income Tax Act, 1961 for the year 2020-21 (1/10th of ₹ 70.00 lakhs incurred in 2019-20).

(iv) Repairs to Plant and Machinery were made during the year for ₹ 140.00 Lakhs and was spread over the period 2020-21 and 2021-22 equally in the books. However, the entire expenditure was allowed for income-tax purposes in the year 2020-21. Tax Rate to be taken at 40%.

You are required to show the impact of above items on Deferred Tax Assets and Deferred Tax Liability as on 31st March, 2021.

*(*July, 2021 Suggested*) (*5 Marks*)*

**Answer**

**Impact of various items in terms of deferred tax liability/deferred tax asset on 31.3.21**

| Transactions | Analysis | Nature of difference | Effect | Amount (₹) |
|---|---|---|---|---|
| Difference in depreciation | Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years. | Responding timing difference | Reversal of DTL | 28 lakhs × 40% = ₹ 11.20 lakhs |
| Disallowances, as per IT Act, of earlier years | Tax payable for the earlier year was higher on this account. | Responding timing difference | Reversal of DTA | 14 lakhs × 40% = 5.6 lakhs |
| Share issue expenses | Due to disallowance of full expenditure under IT Act, tax payable in the earlier years was higher. | Responding timing difference | Reversal of DTA | 7 lakhs × 40% = ₹ 2.8 lakhs |
| Repairs to plant and machinery | Due to allowance of full expenditure under IT Act, tax payable of the current year will be less. | Originating timing difference | Increase in DTL | 70 lakhs × 40% =28 lakhs |

## Question 20

Can an enterprise offset deferred tax assets and deferred tax liabilities? If yes, prescribe the conditions required for such offset as per provisions of AS 22.

(*RTP November 2021*)

**Answer**

Yes. It can offset deferred tax assets and deferred tax liabilities.

As per AS 22, an enterprise should offset deferred tax assets and deferred tax liabilities if:

(i) the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and

(ii) the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

## Question 21

The following transactions were reported by PQR Ltd. during the year 2020-2021:

| | | |
|---|---|---|
| (i) | Tax Rate | 30% |
| (ii) | Items disallowed in 2019-2020 and allowed for tax purposes in 2020-2021. | (₹ in lakh)<br>20.00 |
| (iii) | Interest to Financial Institutions accounted in the books on accrual basis, but actual payment was made before the due date of filing return and allowed for tax purpose also. | 20.00 |
| (iv) | Donations to Private Trust made in 2020-2021 (not allowed under Income Tax Laws). | 10.00 |

You are required to show impact of the above items in terms of Deferred Tax Assets/Deferred Tax Liability for the year ended 31.03.2021.

(*RTP May, 2022*)

**Answer**

**Impact of various items in terms of deferred tax liability/deferred tax asset as per AS 22**

| ***Transactions*** | ***Analysis*** | ***Nature of difference*** | ***Effect*** | ***Amount*** |
|---|---|---|---|---|
| Disallowances, as per IT Act, of earlier years | Tax payable for the earlier year was higher on this account. | Timing difference | Reversal of DTA | ₹ 20 lakh × 30% = ₹ 6 lakh |
| Interest to financial institutions | It is allowed as deduction under IT Act, if the payment is made before the due date of filing the return of income | No timing difference | Not applicable | Not applicable |
| Donation to private trusts | Not an allowable expenditure under IT Act. | Permanent difference | Not applicable | Not applicable |

## Question 22

*The following information is furnished in respect of Mohit Limited for the year ending 31st March,2022.*

(i) *Depreciation as per accounting records ₹ 56,000*

*Depreciation for income tax records ₹ 38,000*

The above depreciation does not include depreciation on new addition.

(ii) *A new machinery purchased on 1st April, 2021 costing ₹ 24,000 on which 100% depreciation in allowed in the 1st Year for income tax purpose, whereas straight line method of depreciation is considered appropriate for accounting purpose with a life estimation of 4 years.*

(iii) The company has made a profit of ₹ 1,28,000 before depreciation and taxes.

*(iv) Donation to private trust during the year is ₹ 15,000* (*not allowed under Income tax laws.*)

*(v) Corporate tax is 40%.*

Prepare relevant extract of statement of Profit & Loss for the year ending 31st March, 2022. Also show the effect of the above items on Deferred Tax Liability/Assets as per AS 22.

(Suggested November, 2022) (5 Marks)

**Answer**

**Statement of profit and Loss for the year ended 31st March, 2022 (An Extract)**

| | ₹ |
|---|---|
| Profit before taxes and depreciation | 1,28,000 |
| Less: Depreciation (56,000+ 6,000) | 62,000 |
| Profit before tax | 66,000 |
| Less: Current tax (W.N) | (32,400) |
| Deferred Tax | Nil |
| Profit after tax | 33,600 |

**Working Note:**

**Computation of taxable income**

| | ₹ |
|---|---|
| Profit before taxes and depreciation | 1,28,000 |
| Less: Depreciation (38,000+ 24,000) | (62,000) |
| | 66,000 |
| Add: Donation* | 15,000 |
| | 81,000 |
| Current tax (40%) | 32,400 |

**Note:** The profit of ₹ 1,28,000 given in the question is before depreciation and taxes. It has been considered that this amount is after making adjustment of donation amounting ₹ 15,000.

**Impact of various items in terms of deferred tax liability/deferred tax asset**

| ***Transactions*** | ***Nature of difference*** | ***Effect*** | ***Amount*** |
|---|---|---|---|
| (1) Difference in depreciation (old machinery) | Timing difference | Reversal of DTL | ₹ 18,000 (56,000 – 38,000) × 40% = (+) ₹ 7,200 |
| (2) Depreciation on new machinery | Timing difference | Creation of DTL | ₹ 18,000 (24,000 – 6,000) x 40% = (-) ₹ 7,200 |
| (3) Donation to private trusts | Permanent difference | Not applicable | -- |
| **Net Effect of Deferred Tax** | | | NIL |

## Question 23

Define followings as per AS 22:

(i) Accounting income (loss)

(ii) Taxable income (tax loss)

(iii) Tax expense (tax saving)

(*RTP November, 2022*)

**Answer**

**Accounting income (loss)** is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income-tax expense or adding income tax saving.

**Taxable income (tax loss)** is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income-tax payable (recoverable) is determined.

**Taxable expenses** is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.

CHAPTER

# 20

# Accounting Standard 7 Construction Contracts

**Question 1**

*XYZ construction Ltd, a construction company undertakes the construction of an industrial complex. It has separate proposals raised for each unit to be constructed in the industrial complex. Since each unit is subject to separate negotiation, he is able to identify the costs and revenues attributable to each unit. Should XYZ Ltd, treat construction of each unit as a separate construction contract according to AS 7?*

(*Source: Illustration 1, Study Material*)

**Answer**

As per AS 7 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

Therefore, XYZ Ltd. is required to treat construction of each unit as a separate construction contract.

**Question 2**

*AB contactors enters into a contract on 1st January 20X1 with XY to construct a 5- storied building. Under the contract, AB is required to complete the construction in 3 years (i.e., by 31st December 20X3). The following information is relevant:*

| | |
|---|---|
| *Fixed price (agreed)* | *₹5 crore* |

*Material cost escalation (to the extent of 20% of increase in material cost) Labour cost escalation (up to 30% of increase in minimum wages)*

*In case AB is able to complete the construction in less than 2 years and 10 months, it will be entitled for an additional incentive of ₹50 lakh. However, in case the construction is delayed beyond 3 years and 2 months, XY will charge a penalty of ₹20 lakh. At the start of the contract, AB has a reason to believe that construction will be completed in 2 years and 8 months. Assume that the construction was actually completed in 2 years 9 months.*

*Labour cost was originally estimated to be ₹1.20 crore (based on initial minimum wages). However, the costs have increased by 25% during the construction period.*

*Material costs have increased by 40% due to short-supply. The total increase in material cost due to the 40% escalation is ₹80 lakh.*

*You are required to suggest what should be the contract revenue in above case?*

*Assume that in year 20X2, XY has requested AB to increase the scope of the contract. An additional floor is required to be constructed and there is an increase in contract fee by ₹1 crore.*

*AB has incurred a cost of ₹20 lakh for getting the local authority approvals which it will be entitled to claim from XY in addition to the increase in the fixed fee.*

*Also measure the total contract revenue in this case.*

(*Source: Illustration 2, Study Material*)

**Answer**

Total Revenue after considering the escalation costs, claims and incentives:

| | ₹ |
|---|---|
| Fixed Price: | 5.00 crore |
| Incentive for early completion | 0.50 crore |
| Material costs recovery (to the extent of 20%) | 0.40 crore |
| Labour costs recovery (Actual increase is less than 30%) [1.20 crore x 25%] | 0.30 crore |
| Total Contract Revenue | 6.20 crore |
| Add: Variation to the contract | 1.00 crore |
| Add: Claims recoverable from XY | 0.20 crore |
| Total Contract Revenue | 7.40 crore |

## Question 3

*X Ltd. commenced a construction contract on 01-04-20X1. The fixed contract price agreed was ₹2,00,000. The company incurred ₹81,000 in 20X1-X2 for 45% work and received ₹79,000 as progress payment from the customer. The cost incurred in 20X2-X3 was ₹89,000 to complete the rest of work. Show the extract of the Profit and Loss Account and Customer's Account for the related years.*

(*Source: Illustration 3, Study Material*)

**Answer**

**Profit & Loss Account**

| Year | | ₹ 000 | Year | | ₹ 000 |
|---|---|---|---|---|---|
| 20X1-X2 | To Construction Costs (for 45% work) | 81 | 20X1-X2 | By Contract Price (45% of Contract Price) | 90 |
| | To Net profit (for 45% work) | 9 | | | |
| | | 90 | | | 90 |
| 20X2-X3 | To Construction costs (for 55% work) | 89 | 20X2-X3 | By Contract Price (55% of Contract Price) | 110 |
| | To Net Profit (for 55% work) | 21 | | | |
| | | 110 | | | 110 |

**Customer's Account**

| *Year* | | *₹ 000* | *Year* | | *₹ 000* |
|---|---|---|---|---|---|
| 20X1-X2 | To Contract Price | 90 | 20X1-X2 | By Bank | 79 |
| | | | | By Balance c/d | 11 |
| | | 90 | | | 90 |
| 20X2-X3 | To Balance b/d | 11 | 20X2-X3 | | |
| | To Contract Price | 110 | | By Bank | 121 |
| | | 121 | | | 121 |

AS 7 provides that the percentage completion method should not be applied if the outcome of a construction contract cannot be estimated reliably. In such cases:

(a) revenue should be recognised only to the extent of contract costs incurred of which recovery is probable; and

(b) contract costs should be recognised as an expense in the period in which they are incurred.

An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35.

## Question 4

*PQ & Associates undertakes a construction contract the details of which are provided below:*

| | |
|---|---|
| *Total Contract Value* | *₹40 lakh* |
| *Costs incurred to date* | *₹3 lakh* |
| *Estimated future costs of completion* | *₹30 lakh* |
| *Work completed* | *10%* |

*The work has started some time ago and there is an uncertainty with respect to the outcome of the contract due to expected changes in regulations. PQ is certain that it would be able to recover the costs incurred to date.*

(*Source: Illustration 4, Study Material*)

**Answer**

In the given case, revenue and costs can only be recognised to the extent of the costs incurred and those which are expected to be recovered. Therefore, the profit & loss statement would appear as under:

| | |
|---|---|
| Contract Revenue | ₹3 lakh |
| Contract Costs | ₹3 lakh |
| Contract Profit | Nil |

When the uncertainties that prevented the outcome of the contract being estimated reliably cease to exist, revenue and expenses associated with the construction contract should be recognised by the percentage completion method.

## Question 5

*X Ltd. commenced a construction contract on 01/04/X1. The contract price agreed was reimbursable cost plus 10%. The company incurred ₹1,00,000 in 20X1-X2, of which cost of ₹90,000 is reimbursable. The further non-reimbursable costs to be incurred to complete the contract are estimated at ₹5,000. The other costs to complete the contract could not be estimated reliably. The Profit & Loss A/c extract of X Ltd. for 20X1-X2 is shown below:*

(*Source: Example 4, Study Material*)

**Answer**

***Profit & Loss Account***

| | *₹ 000* | | *₹ 000* |
|---|---|---|---|
| *To Construction Costs* | *100* | *By Contract Price (90+9)* | *99* |
| *To Provision for loss* | *5* | *Net loss* | *6* |
| | *105* | | *105* |

## Question 6

*Show Profit & Loss A/c (Extract) in books of a contractor in respect of the following data for Year 1.*

| ***Information for Year 1*** | *₹ 000* |
|---|---|
| *Contract price (Fixed)* | *600* |
| *Cost incurred to date* | *390* |
| *Estimated cost to complete* | *260* |

Assume that the contract period is 2 years. The contract is 100% completed by Year 2. Actual costs incurred is the same as total estimated costs to complete (Cost incurred to date plus estimated cost to complete).

(*Source: Illustration 5, Study Material*)

**Answer**

| | | ***Amount INR ₹ 000*** | |
|---|---|---|---|
| | ***Year (1)*** | ***Total up to Year2 (2)*** | ***Year 2 (2) – (1)*** |
| *A. Cost incurred to date* | *(390)* | *(650)* | *(260)* |
| *B. Estimate of cost to completion* | *(260)* | *-* | *-* |

| | | ***Amount INR ₹ 000*** | |
|---|---|---|---|
| | ***Year (1)*** | ***Total up to Year2 (2)*** | ***Year 2 (2) – (1)*** |
| *C. Estimated total cost* | *(650)* | *650* | *650* |
| *D. Degree of completion (A/C)* | *60%* | *100%* | *40%* |
| *E. Revenue Recognised* | | | |
| *(60% of 600)* | *360* | | |
| *(100% of 600)* | | *600* | *240* |
| *Total foreseeable loss (650 – 600)* | *50* | | |
| *Less: Loss for current year (E – A)* | *(30)* | | |
| *Expected loss to be recognised immediately* | *(20)* | | |
| *Reversal of Loss provision in Year 2* | | | *20* |

***Profit & Loss A/c (Year 1)***

| | *₹* | | *₹* |
|---|---|---|---|
| *To Construction costs To Provision for loss* | *390*<br>*20* | *By Contract Price By Net Loss* | *360*<br>*50* |
| | *410* | | *410* |

***Profit & Loss A/c (Year 2)***

| | *₹* | | *₹* |
|---|---|---|---|
| *To Construction costs* | *260* | *By Contract Price*<br>*By Reversal of Provision for loss* | *240*<br>*20* |
| | *260* | | *260* |

## Question 7

*A firm of contractors obtained a contract for construction of bridges across river Revathi. The following details are available in the records kept for the year ended 31st March, 20X1.*

| | ***(₹ in lakhs)*** |
|---|---|
| *Total Contract Price* | *1,000* |
| *Work Certified for the cost incurred* | *500* |
| *Work yet not Certified for the cost incurred* | *105* |
| *Estimated further Cost to Completion* | *495* |
| *Progress Payment Received* | *400* |
| *To be Received* | *140* |

*The firm seeks your advice and assistance in the presentation of accounts keeping in view the requirements of AS 7 issued by your institute.*

(*Source: Illustration 6, Study Material*)

**Answer**

| (a) | | **(₹ in lakhs)** |
|---|---|---|
| | Amount of foreseeable loss: | |
| | Total cost of construction (500 + 105 + 495) | 1,100 |
| | *Less*: Total contract price | (1,000) |
| | Total foreseeable loss to be recognized as expense | 100 |

According AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

| **(b)** | | **(₹ in lakhs)** |
|---|---|---|
| | Contract work-in-progress i.e. cost incurred to date are ₹ 605 lakhs | |
| | Work certified | 500 |
| | Work not certified | 105 |
| | | 605 |

This is 55% (605/1,100 × 100) of total costs of construction.

(c) Proportion of total contract value recognized as revenue: 55% of ₹ 1,000 lakhs = ₹ 550 lakhs

(d) Gross Amount due from/to customers = (Contract costs + Recognized profits – Recognized Losses) – (Progress payments received + Progress payments to be received)

= (605 + Nil – 100) – (400 + 140) ₹ in lakhs

= [505 – 540] ₹ in lakhs

Amount due to customers = ₹ 35 lakhs

The amount of ₹ 35 lakhs will be shown in the balance sheet as liability.

(e) The relevant disclosures under AS 7 are given below:

| | **₹ in lakhs** |
|---|---|
| Contract revenue | 550 |
| Contract expenses | 605 |
| Recognised profits less recognised losses | (100) |
| Progress billings ₹ (400 + 140) | 540 |
| Retentions (billed but not received from contractee) | 140 |
| Gross amount due to customers | 35 |
| Method of revenue recognition (use of percentage completion method) Method of determining state of completion (based on proportionate cost | |

## Question 8

*On 1st December, 20X1, Vishwakarma Construction Co. Ltd. undertook a contract to construct a building for ₹ 85 lakhs. On 31st March, 20X2, the company found that it had already spent ₹ 64,99,000 on the construction. Prudent estimate of additional cost for completion was ₹ 32,01,000. What amount should be recognized in the statement of profit and loss for the year ended 31st March, 20X2 as per provisions of Accounting Standard 7 (Revised)?*

(*Source: Illustration 7, Study Material*)

**Answer**

| | ₹ |
|---|---|
| Cost incurred till 31st March, 20X2 | 64,99,000 |
| Prudent estimate of additional cost for completion | 32,01,000 |
| Total cost of construction | 97,00,000 |
| *Less:* Contract price | (85,00,000) |
| Total foreseeable loss | 12,00,000 |

According to AS 7, the amount of ₹ 12,00,000 is required to be recognised as an expense.

Contract work in progress = $\frac{\text{Rs. } 64,99,000 \times 100}{\text{Rs. } 97,00,000} = 67\%$

Proportion of total contract value recognised as turnover:

= 67% of ₹ 85,00,000 = ₹ 56,95,000.

The amount of expected loss will be split as under:

| Particulars | Workings | Amount |
|---|---|---|
| Expected Loss | 97,00,000– 85,00,000 | 12,00,000 |
| Contract revenue | 67% of 85,00,000 | 56,95,000 |
| Contract cost | Given | 64,99,000 |
| Actual loss | 56,95,000– 64,99,000 | 8,04,000 |
| Amount of provision required [As per Para 35] | 12,00,000– 8,04,000 | 3,96,000 |

## Question 9

*It is argued that profit on construction contracts should not be recognised until the contract is completed. Please explain whether you believe that this suggestion would improve the quality of financial reporting for long-term construction contracts.*

(*Source: Theory Question 7, Study Material*)

**Answer**

Usually, construction contracts are long term nature i.e., the contracts are entered in one accounting period, however, the work performed will flow into more than one accounting year. If the profit on construction contracts is not recognised over the construction period, then the costs incurred during the earlier years of the contract would be recognised without any corresponding revenue. This will result in losses for initial years followed high profits in future years.

The current treatment under AS 7 results in matching of revenue and associated costs as they are recognised during the same period. Also, the current accounting incorporates the prudence concept as any foreseeable losses are accounted for immediately.

Therefore, AS 7 results in a fair representation of the underlying financial substance of the transaction.

## Question 10

*A contractor has entered into a contract with a municipal body for construction of a flyover. As per the contract terms, the contractor will receive an additional ₹ 2 Crore as incentive if the construction of the flyover were to be finished within a period of two years from the start of the contract. The contractor wants to recognize this revenue since in the past he has been able to meet similar targets very easily.*

*Explain whether the contractor's view-point is correct?*

(*Source: Theory Question 8, Study Material*)

**Answer**

The contractor's view is not entirely correct in considering the variation as a part of contract revenue. There is an argument that he has been able to complete similar contracts within stipulated time. However, each contract needs to be assessed in isolation with respect to the specific challenges associated with the timing and uncertainty in completion.

Accordingly, the contractor needs to validate the assumptions with respect to the specific contract. Only after that assessment is done, the incentive of ₹ 2 crore may be included within the contract revenue.

## Question 11

*A construction contractor has a fixed price contract for ₹ 9,000 lakhs to build a bridge in 3 years time frame. A summary of some of the financial data is as under:*

| | (Amount ₹ in lakhs) | | |
|---|---|---|---|
| | **Year 1** | **Year 2** | **Year 3** |
| Initial Amount for revenue agreed in contract | 9,000 | 9,000 | 9,000 |
| Variation in Revenue (+) | - | 200 | 200 |
| Contracts costs incurred up to the reporting date | 2,093 | 6,168* | 8,100** |
| Estimated profit for whole contract | 950 | 1,000 | 1,000 |

*Includes ₹ 100 lakhs for standard materials stored at the site to be used in year 3 to complete the work.

**Excludes ₹ 100 lakhs for standard material brought forward from year 2. The variation in cost and revenue in year 2 has been approved by customer.

Compute year wise amount of revenue, expenses, contract cost to complete and profit or loss to be recognized in the Statement of Profit and Loss as per AS-7 (revised).

(*Source: Practical Question 9, Study Material*)

**Answer**

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are computed below:

*(Amount in ₹ lakhs)*

| | ***Up to the reporting date*** | ***Recognized in previous years*** | ***Recognized in current year*** |
|---|---|---|---|
| Year 1 | | | |
| Revenue (9,000 x 26%) | 2,340 | - | 2,340 |
| Expenses (8,050 x 26%) | 2,093 | - | 2,093 |
| Profit | 247 | - | 247 |
| Year 2 | | | |
| Revenue (9,200 x 74%) | 6,808 | 2,340 | 4,468 |
| Expenses (8,200 x 74%) | 6,068 | 2,093 | 3,975 |
| Profit | 740 | 247 | 493 |
| Year 3 | | | |
| Revenue (9,200 x 100%) | 9,200 | 6,808 | 2,392 |
| Expenses (8,200 x 100%) | 8,200 | 6,068 | 2,132 |
| Profit | 1,000 | 740 | 260 |

**Working Note:**

| | ***Year 1*** | ***Year 2*** | ***Year 3*** |
|---|---|---|---|
| Revenue after considering variations | 9,000 | 9,200 | 9,200 |
| *Less*: Estimated profit for whole contract | 950 | 1,000 | 1,000 |
| Estimated total cost of the contract (A) | 8,050 | 8,200 | 8,200 |
| Actual cost incurred upto the reporting date (B) | 2,093 | 6,068 (6,168-100) | 8,200 (8,100+100) |
| Degree of completion (B/A) | 26% | 74% | 100% |

## Question 12

Akar Ltd. Signed on 01/04/X1, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the year ended 31/03/X2.

- Materials used ₹ 71,00,000
- Labour charges paid ₹ 36,00,000
- Hire charges of plant ₹ 10,00,000
- Other contract cost incurred ₹ 15,00,000
- Labour charges of ₹ 2,00,000 are still outstanding on 31.3.X2.
- It is estimated that by spending further ₹ 33,50,000 the work can be completed in all respect.

You are required to compute profit/loss for the year to be taken to Profit & Loss Account and any provision for foreseeable loss to be recognized as per AS 7.

(*Source: Practical Question 10, Study Material*)

**Answer**

Statement showing the amount of profit/loss to be taken to Profit and Loss Account and additional provision for the foreseeable loss as per AS 7

| | Cost of Construction | ₹ | ₹ |
|---|---|---|---|
| | Material used | | 71,00,000 |
| | Labour Charges paid | 36,00,000 | 38,00,000 |
| *Add:* | Outstanding on 31.03.20X2 | | 10,00,000 |
| | | 2,00,000 | 15,00,000 |
| | Hire Charges of Plant | | 1,34,00,000 |
| | Other Contract cost incurred | | |
| | Cost incurred upto 31.03.20X2 | | |
| *Add:* | Estimated future cost | | 33,50,000 |
| | Total Estimated cost of construction | | 1,67,50,000 |
| | Degree of completion (1,34,00,000/1,67,50,000 x 100) | | 80% |
| | Revenue recognized (80% of 1,50,00,000) | | 1,20,00,000 |
| | Total foreseeable loss (1,67,50,000 - 1,50,00,000) | | 17,50,000 |
| *Less:* | Loss for the current year (1,34,00,000 - 1,20,00,000) | | 14,00,000 |
| | Loss to be provided for | | 3,50,000 |

## Question 13

RT Enterprises has entered into a fixed price contract for construction of a tower with its customer. Initial tender price agreed is ₹ 220 crore. At the start of the contract, it is estimated that total costs to be incurred will be ₹ 200 crore. At the end of year 1, this estimate stands revised to ₹ 202 crore. Assume that the construction is expected to be completed in 3 years.

During year 2, the customer has requested for a variation in the contract. As a result of that, the total contract value will increase by ₹ 5 crore and the costs will increase by ₹ 3 crore.

RT has decided to measure the stage of completion on the basis of the proportion of contract costs incurred to the total estimated contract costs. Contract costs incurred at the end of each year is:

Year 1: ₹ 52.52 crore

Year 2: ₹ 154.20 crore (including unused material of 2.5 crore)

Year 3: ₹ 205 crore.

You are required to calculate:

(a) Stage of completion for each year.

(b) Profit to be recognised for each year.

(*Source: Practical Question 11, Study Material*)

**Answer**

(a) Stage of completion = Costs incurred to date / Total estimated costs

Year 1: 52.52 crore / 202 crore = 26%

Year 2: (154.20 crore – 2.50 crore) / 205 crore = 74%

Year 3: 205 crore / 205 crore = 100%

(b) Profit for the year

| | Year 1 | Year 2 | Year 3 |
|---|---|---|---|
| Contract Revenue (1) | 57.20 crore | 109.30 crore | 58.50 crore |
| | (220 crore x 26%) | (225 crore x 74% - 57.20 crore) | (225 crore x 100% - 109.30 crore – 57.20 crore) |
| Contract Cost (2) | 52.52 crore | 99.18 crore | 53.30 crore |
| | (202 crore x 26%) | (205 crore x 74% - 52.52 crore) | (205 crore x 100% - 99.18 crore – 52.52 crore) |
| Contract Profit (1) – (2) | 4.68 crore | 10.12 crore | 5.20 crore |

# QUESTION BANK

## Question 14

Sarita Construction Co. obtained a contract for construction of a dam. The following details are available in records of company for the year ended 31st March, 2018:

| | **₹ in lakhs** |
|---|---|
| Total Contract Price | 12,000 |
| Work Certified | 6,250 |
| Work not certified | 1,250 |
| Estimated further cost to completion | 8,750 |
| Progress payment received | 5,500 |
| Progress payment to be received | 1,500 |

Applying the provisions of Accounting Standard 7 "Accounting for Construction Contracts" you are required to compute:

(i) Profit/Loss for the year ended 31st March, 2018.
(ii) Contract work in progress as at end of financial year 2017-18.
(iii) Revenue to be recognized out of the total contract value.
(iv) Amount due from/to customers as at the year end.

*(May 2018) (5 Marks)*

**Answer:**

| **(i)** | **Loss for the year ended, 31st March, 2018** | **(₹ in lakhs)** |
|---|---|---|
| | Amount of foreseeable loss | |
| | Total cost of construction (6,250 + 1,250 + 8,750) | 16,250 |
| | Less: Total contract price | (12,000) |
| | Total foreseeable loss to be recognised as expense | 4,250 |

According to AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

Loss for the year ended, 31st March, 2018 amounting ₹4,250 will be recognized.

| **(ii)** | **Contract work-in-progress as on 31.3.18** | **(₹ in lakhs)** |
|---|---|---|
| | Contract work-in-progress i.e. cost incurred to date are ₹7,500 lakhs: | |
| | Work certified | 6,250 |
| | Work not certified | 1,250 |
| | | 7,500 |

**(iii) Proportion of total contract value recognised as revenue**

Cost incurred till 31.3.18 is 46.15% (7,500/16,250 x 100) of total costs of construction.

Proportion of total contract value recognised as revenue:

46.15% of ₹12,000 lakhs = ₹5,538 lakhs

**(iv) Amount due from/to customers at year end**

(Contract costs + Recognised profits - Recognised Losses) - (Progress payments received + Progress payments to be received)

= (7,500 + Nil - 4,250) - (5,500 + 1,500) ₹ in lakhs

= [3,250-7,000] 7 in lakhs

Amount due to customers = ₹3,750 lakhs

## Question 15

Uday Constructions undertake to construct abridge for the Government of Uttar Pradesh. The construction commenced during the financial year ending 31.03.2016 and is likely to be completed by the next financial year. The contract is for a fixed price of ₹12 crores with an escalation clause. The costs to complete the whole contract are estimated at ₹9.50 crores of rupees. You are-given the following information for the year ended 31.03.2016:

Cost incurred upto 31.03.2016 ₹4 crores

Cost estimated to complete the contract ₹6 crores

Escalation in cost by 5% and accordingly the contract price is increased by 5%.

You are required to identify the state of completion and calculate the revenue and profit to be recognized for the year as per AS 7.

(*RTP May 2018*)

**Answer:**

| | **₹ in crore** |
|---|---|
| Cost of construction of bridge incurred 31.3.16 | 4.00 |
| Add: Estimated future cost | 6.00 |
| Total estimated cost of construction | 10.00 |
| Contract Price (12 crore x 1.05) | 12.60 crore |

**Stage of completion**

Percentage of completion till date to total estimated cost of construction

= (4/10) x 100 = 40%

**Revenue and Profit to be recognized for the year ended 31st March, 2016 as per AS 7**

Proportion of total contract value recognized as revenue = Contract price x percentage of completion

= ₹12.60 crore x 40% = ₹5.04 crore

Profit for the year ended 31st March, 2016 = ₹5.04 crore less ₹4 crore = 1.04 crore

## Question 16

(i) AP Ltd., a construction contractor, undertakes the construction of commercial complex for Kay Ltd. AP Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreement is entered into between the two parties. The agreement lays down the value of each of the 3 units, i.e. ₹50 Lakh, ₹60 Lakh and ₹75 Lakh respectively. Agreement also lays down the completion time for each unit.

Comment, with reference to AS-7, whether AP Ltd., should treat it as a single contract or three separate contracts.

(ii) On 1st December, 2017, GR Construction Co. Ltd. undertook a contract to construct a building for ₹45 lakhs. On 31st March, 2018, the company found that it had already spent ₹32.50 lakhs on the construction. Additional cost of completion is estimated at ₹15.10 lakhs. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2018 as per provision of AS-7?

(*May 2019*) (*5 Marks*)

**Answer:**

**(i)** As per AS 7 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

Therefore, Mr. AP Ltd. is required to treat construction of each unit as a separate construction contract as the above-mentioned conditions of AS 7 are fulfilled in the given case.

**(ii)**

| | ₹ *in lakhs* |
|---|---|
| Cost of construction incurred till date | 32.50 |
| *Add*: Estimated future cost | 15.10 |
| Total estimated cost of construction | 47.60 |

Percentage of completion till date to total estimated cost of construction

= (32.50/47.60) × 100 = 68.28%

Proportion of total contract value recognised as revenue for the year ended 31st Marc h, 2018 per AS 7 (Revised)

= Contract price x percentage of completion

= ₹45 lakh x 68.28% = ₹30.73 lakhs.

| | ***(₹ in lakhs)*** |
|---|---|
| Total cost of construction | 47.60 |
| *Less*: Total contract price | (45.00) |
| Total foreseeable loss to be recognized as expense | 2.60 |

According to of AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

## Question 17

On 1st December, 2018, "Sampath" Construction Company Limited undertook a contract to construct a building for ₹108 lakhs. On 31st March, 2019 the company found that it had already spent ₹83.99 lakhs on the construction. A prudent estimate of additional cost for completion was ₹36.01 lakhs.

You are required to compute the amount of provision for foreseeable loss, which must be made in the Final Accounts for the year ended 31st March, 2019 based on AS 7 "Accounting for Construction Contracts."

(*RTP November 2019*)

**Answer:**

**Calculation of foreseeable loss for the year ended 31st March, 2019**

(as per AS 7 "Construction Contracts")

| | *(₹ in lakhs)* |
|---|---:|
| Cost incurred till 31st March, 2019 | 83.99 |
| Prudent estimate of additional cost for completion | 36.01 |
| Total cost of construction | 120.00 |
| *Less:* Contract price | (108.00) |
| Foreseeable loss | 12.00 |

According to para 35 of AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue; the expected loss should be recognized as an expense immediately. Therefore, amount of ₹12 lakhs is required to be provided for in the books of Sampath Construction Company for the year ended 31st March, 2019.

## Question 18

M/s Excellent Construction Company Limited undertook a contract to construct a building for ₹3 Crore on 1st September, 2011. On 31st March, 2012 the company found that it had already spent ₹1 Crore 80 Lakhs on the construction. Prudent estimate of additional cost for completion was ₹1 Crore 40 Lakhs. What amount should be charged, to revenue in the final accounts for the year ended on 31st March, 2012, as per the provisions of Accounting Standard 7 "Construction Contracts (Revised)"?

(*May 2012, 5 Marks*)

## Question 19

M/s. Highway Constructions undertook the construction of a highway on 01.04.2013. The contract was to be completed in 2 years. The contract price was estimated at ₹150 crores. Up to 31.03.2014 the company incurred ₹ 120 crores and the construction. The engineers involved in the project estimated that a further ₹ 45 crores would be incurred for completing the work.

What amount should be charged to revenue for the year 2013-14 as per the provisions of Accounting Standard 7 "Construction Contracts"? Show the extract of the Project & Loss A/c in the books of M/s. Highway Constructions.

(*May 2014, 5 Marks*)

**Answer:**

**Statement showing the amount to be charged to Revenue as per AS 7**

| | | ₹ in crores |
|---|---|---:|
| | Cost of construction incurred upto 31.03.2014 | 120 |
| *Add:* | Estimated future cost | 45 |
| | Total estimated cost of construction | 165 |
| | Degree of completion (120/165 x 100) | 72.73% |
| | Revenue recognized (72.73% of 150) | 109 (approx) |
| | Total foreseeable loss (165 – 150) | 15 |
| *Less:* | Loss for the current year (120 – 109) | 11 |
| | Loss to be provided for | 4 |

**Profit and Loss Account (Extract)**

| | ₹ in crores | | ₹ in crores |
|---|---:|---|---:|
| To Construction Costs | 120 | By Contract Price | 109 |
| To Provision for loss | 4 | By Net loss | 15 |
| | 124 | | 124 |

## Question 20

A construction contractor has a fixed price contract for ₹ 9,000 lacs to build a bridge in 3 years time frame. A summary of some of the financial data is as under:

| | (Amount ₹ in lacs) | | |
|---|---:|---:|---:|
| | Year 1 | Year 2 | Year 3 |
| Initial Amount for revenue agreed in contract | 9,000 | 9,000 | 9,000 |
| Variation in Revenue (+) | — | 200 | 200 |
| Contracts costs incurred up to the reporting date | 2093 | 6168* | 8100** |
| Estimated profit for whole contract | 950 | 1,000 | 1,000 |

*Includes ₹ 100 lacs for standard materials stored at the site to be used in year 3 to complete the work.

**Excludes ₹ 100 lacs for standard material brought forward from year 2.

The variation in cost and revenue in year 2 has been approved by customer.

Compute year wise amount of revenue, expenses, contract cost to complete and profit or loss to be recognized in the Statement of Profit and Loss as per AS-7 (revised).

(*May 2015, 5 Marks*)

**Answer**

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are shown below:

(Amount in ₹ lakhs)

| | Upto the reporting date | Recognized in prior years | Recognized in current year |
|---|---|---|---|
| **Year 1** | | | |
| Revenue (9,000 x 26%) | 2,340 | - | 2,340 |
| Expenses (8,050 x 26%) | 2,093 | - | 2,093 |
| Profit | 247 | - | 247 |
| **Year 2** | | | |
| Revenue (9,200 x 74%) | 6,808 | 2,340 | 4,468 |
| Expenses (8,200 x 74%) | 6,068 | 2,093 | 3,975 |
| Profit | 740 | 247 | 493 |
| **Year 3** | | | |
| Revenue (9,200 x 100%) | 9,200 | 6,808 | 2,392 |
| Expenses (8,200 x 100%) | 8,200 | 6,068 | 2,132 |
| Profit | 1,000 | 740 | 260 |

**Working Note:**

| | Year 1 | Year 2 | Year 3 |
|---|---|---|---|
| Revenue after consider variations | 9,000 | 9,200 | 9,200 |
| Less: Estimated profit for whole contract | 950 | 1,000 | 1,000 |
| Estimated total cost of the contract (A) | 8,050 | 8,200 | 8,200 |
| Actual cost incurred upto the reporting date (B) | 2,093 | 6,068 | 8,200 |
| | | (6,168-100) | (8,100+100) |
| Degree of completion (B/A) | 26% | 74% | 100% |

## Question 21

GTI Ltd. Negotiates with Bharat Oil Corporation Ltd. (BOCL), for construction of "Retail Petrol & Diesel Outlet Stations". Based on proposals submitted to different Regional Offices of BOCL, the final approval for one outlet each in Region X, Region Y, Region Z is awarded to GTI Ltd. A single agreement is entered into between two. The agreement lays down values for each of the three outlets i.e. ₹ 102 lacs. ₹ 150 lacs, ₹ 130 lacs for Region X, Region Y, Region Z respectively. Agreement also lays down completion time for each Region.

Comment whether GTI Ltd. will treat it as single contract or three separate contracts with reference to AS-7?

(*Group I, November 2016, 5 Marks*)

**Answer**

As per AS 7 'Construction Contracts', when a contract covers number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

In the given case, each outlet is submitted as a separate proposal to different Zonal Offices, which can be separately negotiated, and costs and revenues thereof can be separately identified. Hence, each asset will be treated as a "single contract" even if there is one single agreement for contracts.

Therefore, three separate contract accounts must be recorded and maintained in the books of GTI Ltd. For each contract, principles of revenue and cost recognition must be applied separately and net income will be determined for each asset as per AS 7.

## Question 22

Akar Ltd. signed on 01/04/19, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the period ending 31/03/20.

- Materials used ₹ 71,00,000
- Labour charges paid ₹ 36,00,000
- Hire charges of plant ₹ 10,00,000
- Other contract cost incurred ₹ 15,00,000
- Labour charges of ₹ 2,00,000 are still outstanding on 31.3.20.
- It is estimated that by spending further ₹ 33,50,000 the work can be completed in all respect.

You are required to compute profit/loss for the year to be taken to Profit & Loss Account and additional provision for foreseeable loss to be recognized as per AS 7.

(*MTP, October, 2020*) (*5 marks*)

**Answer**

**Statement showing the amount of profit/loss to be taken to Profit and Loss Account and additional provision for the foreseeable loss as per AS 7**

| **Cost of Construction** | | ₹ | ₹ |
|---|---|---|---|
| | Material used | | 71,00,000 |
| | Labour Charges paid | 36,00,000 | |
| *Add:* | Outstanding on 31.03.2020 | 2,00,000 | 38,00,000 |
| | Hire Charges of Plant | | 10,00,000 |
| | Other Contract cost incurred | | 15,00,000 |
| | Cost incurred upto 31.03.2020 | | 1,34,00,000 |
| *Add:* | Estimated future cost | | 33,50,000 |
| | Total Estimated cost of construction | | 1,67,50,000 |
| | Degree of completion (1,34,00,000/1,67,50,000 x 100) | | 80% |
| | Revenue recognized (80% of 1,50,00,000) | | 1,20,00,000 |
| | Total foreseeable loss (1,67,50,000 - 1,50,00,000) | | 17,50,000 |
| *Less:* | Loss for the current year (1,34,00,000 - 1,20,00,000) | | 14,00,000 |
| Loss to be provided for | | | 3,50,000 |

## Question 23

(a) Sky Limited belongs to Heavy Engineering Contractors specializing in construction of Flyovers. The company just entered into a contract with a local municipal corporation for building a flyover. No activity has started on this contract. As per the terms of the contract, Sky Limited will receive an additional ₹ 50 lakhs if the construction of the flyover were to be finished within a period of two years from the commencement of the contract. The Accountant of the entity wants to recognize this revenue since in the past the company has been able to meet similar targets very easily. Give your opinion on this treatment.

(b) ABC Ltd., a construction contractor, undertakes the construction of commercial complex for XYZ Ltd. ABC Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreement is entered into between the two parties. The agreement lays down the value of each of the 3 units i .e. ₹ 50 lakh, ₹ 60 lakh and ₹ 75 lakh respectively. Agreement also lays down the completion time for each unit. Comment, with reference to AS 7, whether ABC Ltd., should treat it as a single contract or three separate contracts.

(*RTP, May, 2021*)

**Answer**

**(a)** According to AS 7 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when both the conditions are met:

(i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and

(ii) the amount of the incentive payment can be measured reliably.

In the given problem, the contract has not even begun and hence the contractor (Sky Limited) should not recognize any revenue of this contract. Therefore, the accountant's contention for recognizing ₹ 50 lakhs as revenue is not correct.

**(b)** As per AS 7 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

ABC Ltd. has submitted separate proposals for each of the 3 units of commercial complex. Also the revenue and completion time has been laid down for each unit separately which implies separate negotiation for them.

Therefore, ABC Ltd. is required to treat construction of each unit as a separate construction contract as the above-mentioned conditions of AS 7 are fulfilled in the given case.

## Question 24

Rajendra undertook a contract ₹ 20,00,000 on an arrangement that 80% of the value of work done, as certified by the architect of the contractee should be paid immediately and that the remaining 20% be retained until the Contract was completed.

In Year 1, the amounts expended were ₹ 8,60,000, the work was certified for ₹ 8,00,000 and 80% of this was paid as agreed. It was estimated that future expenditure to complete the Contract would be ₹ 10,00,000.

In Year 2, the amounts expended were ₹ 4,75,000. Three-fourth of the work under contract was certified as done by December 31st and 80% of this was received accordingly. It was estimated that future expenditure to complete the Contract would be ₹ 4,00,000.

In Year 3, the amounts expended were ₹ 3,10,000 and on June 30th, the whole Contract was completed.
Show how Contract revenue would be recognized in the P & L A/c of Mr. Rajendra each year.

(Suggested, November, 2020) (5 marks)

**Answer**

**Year 1**

| | ₹ |
|---|---|
| Actual expenditure | 8,60,000 |
| Future estimated expenditure | 10,00,000 |
| Total Expenditure | 18,60,000 |

$$\%\text{ of work compled} = \frac{8,60,000}{18,60,000} \times 100 = 46.24\% \text{ (rounded off)}$$

Revenue to be recognized = 20,00,000 x 46.24%
= ₹ 9,24,800

**Year 2**

| | |
|---|---|
| Actual expenditure | 4,75,000 |
| Future Expenditure | 4,00,000 |
| Expenditure incurred in Year 1 | 8,60,000 |

% of work completed

$$= \frac{4,75,000 + 8,60,000}{17,35,000} = 76.95\% \text{ (rounded off)}$$

Revenue to be recognized (cumulative) = 20,00,000 x 76.95%
= 15,39,000
Less: revenue recognized in Year 1 = ( 9,24,800)
Revenue to be recognized in Year 2 ₹ 6,14,200

**Year 3**

Whole contract got completed therefore total contract value less revenue recognized up to year 2 will be amount of revenue to be recognized in year 3 i.e. 20,00,000 – 15,39,000 (9,24,800 + 6,14,200) = ₹ 4,61,000.

Note: Calendar year has been considered as accounting year.

## Question 25

The following data is provided for M/s. Raj Construction Co.

(i) Contract Price - ₹ 85 lakhs
(ii) Materials issued - ₹ 21 Lakhs out of which Materials costing ₹ 4 Lakhs is still lying unused at the end of the period.
(iii) Labour Expenses for workers engaged at site - ₹ 16 Lakhs (out of which ₹ 1 Lakh is still unpaid)
(iv) Specific Contract Costs - ₹ 5 Lakhs
(v) Sub-Contract Costs for work executed - ₹ 7 Lakhs, Advances paid to sub-contractors - ₹ 4 Lakhs
(vi) Further Cost estimated to be incurred to complete the contract - ₹ 35 Lakhs

You are required to compute the Percentage of Completion, the Contract Revenue and Cost to be recognized as per AS-7.

(*July, 2021 Suggested)* (*5 Marks*)

**Answer**

**Computation of contract cost**

| | **₹ Lakh** | **₹ Lakh** |
|---|---|---|
| Material cost incurred on the contract (net of closing stock) | 21-4 | 17 |
| Add: Labour cost incurred on the contract (including outstanding amount) | | 16 |
| Specified contract cost | given | 5 |
| Sub-contract cost (advances should not be considered) | | 7 |
| Cost incurred (till date) | | 45 |
| Add: further cost to be incurred | | 35 |
| Total contract cost | | 80 |

**Percentage of completion** = Cost incurred till date/Estimated total cost
= ₹ 45,00,000/₹ 80,00,000
= 56.25%

**Contract revenue and costs to be recognized**

Contract revenue (₹ 85,00,000 x 56.25%) = ₹ 47,81,250 Contract costs = ₹ 45,00,000

## Question 26

PRZ & Sons Ltd. are Heavy Engineering contractors specializing in construction of dams. From the records of the company, the following data is available pertaining to year ended 31st March, 2021:

| | **(₹ crore)** |
|---|---|
| Total Contract Price | 2,400 |
| Work Certified | 1,250 |
| Work pending certification | 250 |
| Estimated further cost to completion | 1,750 |
| Stage wise payments received | 1,100 |
| Progress payments in pipe line | 300 |

Using the given data and applying the relevant Accounting Standard you are required to:

(i) Compute the amount of profit/loss for the year ended 31st March, 2021.

(ii) Arrive at the contract work in progress as at the end of financial year 2020-21.

(iii) Determine the amount of revenue to be recognized out of the total contract value.

(iv) Work out the amount due from/to customers as at year end.

(*MTP*, *October 2021*) (*5 Marks*)

**Answer**

| **(i)** | **Calculation of profit/ loss for the year ended 31st March, 2021** | **(₹ *in crores*)** |
|---|---|---|
| | Total estimated cost of construction (1,250 + 250 + 1,750) | 3,250 |
| | *Less*: Total contract price | (2,400) |
| | Total foreseeable loss to be recognized as expense | 850 |

According to AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

| **(ii)** | **Contract work-in-progress i.e. cost incurred to date** | **(₹ *in crores*)** |
|---|---|---|
| | Work certified | 1,250 |
| | Work not certified | 250 |
| | | 1,500 |

**(iii) Proportion of total contract value recognised as revenue**

Percentage of completion of contract to total estimated cost of construction

= (1,500 / 3,250) × 100 = 46.15%

Revenue to be recognized till date = 46.15% of ₹ 2,400 crores = ₹ 1,107.60 crores.

**(iv) Amount due from / to customers** = Contract costs + Recognised profits – Recognised losses – (Progress payments received + Progress payments to be received)

= ₹ [1,500 + Nil – 850 – (1100 + 300)] crores

= ₹ [1,500 – 850 – 1,400] crores

Amount due to customers (shown as liability) = ₹ 750 crores.

## Question 27

(a) In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably only when certain conditions prescribed under AS 7 are satisfied. You are required to describe these conditions mentioned in the standard.

(b) Mr. 'X' as a contractor has just entered into a contract with a local municipal body for building a flyover. As per the contract terms, 'X' will receive an additional ₹ 2 crore if the construction of the flyover were to be finished within a period of two years of the commencement of the contract. Mr. X wants to recognize this revenue since in the past he has been able to meet similar targets very easily. Is X correct in his proposal? Discuss.

(*RTP November 2021*)

**Answer**

**(a)** In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:

(i) total contract revenue can be measured reliably;

(ii) it is probable that the economic benefits associated with the contract will flow to the enterprise;

(iii) both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and

(iv) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

**(b)** According to AS 7 (Revised) 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when: (i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and (ii) the amount of the incentive payment can be measured reliably. In the given problem, the contract has not even begun and hence the contractor (Mr. X) should not recognize any revenue of this contract.

## Question 28

B Ltd. undertook a construction contract for ₹ 50 crores in April, 2020. The cost of construction was initially estimated at ₹ 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated that the cost of completion of the contract would be ₹ 53 crores.

Can the company provide for the expected loss in the financial Statements for the year ended 31st March, 2021? Explain.

(*RTP May, 2022*)

**Answer**

As per para 35 of AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately. Therefore, the foreseeable loss of ₹ 3 crores (₹ 53 crores less ₹ 50 crores) should be recognized as an expense immediately in the year ended 31st March, 2021. The amount of loss is determined irrespective of

(i) Whether or not work has commenced on the contract;

(ii) Stage of completion of contract activity; or

(iii) The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance provisions of AS 7.

## Question 29

On 1st December, 2021, GR Construction Co. Ltd. undertook a contract to construct a building for ₹ 45 lakhs. On 31st March, 2022, the company found that it had already spent ₹ 32.50 lakhs on the construction. Additional cost of completion is estimated at ₹ 15.10 lakhs. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2022 as per provisions of AS-7?

(*RTP May, 2023*)

**Answer**

| | ***₹ in lakhs*** |
|---|---|
| Cost of construction incurred till date | 32.50 |
| *Add*: Estimated future cost | 15.10 |
| Total estimated cost of construction | 47.60 |

Percentage of completion till date to total estimated cost of construction

= (32.50/47.60) x 100 = 68.28%

Proportion of total contract value recognised as revenue for the year ended 31st March, 2022 per AS 7 (Revised)

= Contract price x percentage of completion

= ₹ 45 lakh x 68.28% = ₹ 30.73 lakhs.

| | ***(₹ in lakhs)*** |
|---|---|
| Total cost of construction | 47.60 |
| *Less*: Total contract price | (45.00) |
| Total foreseeable loss to be recognized as expense | 2.60 |

According to of AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

## Question 30

Fisher Construction Co. obtained a contract for construction of a 5 commercial complex. The following details are available in records of a company for the year ended 31st March, ,2023 :

| Particulars | Amount in lakhs |
|---|---|
| Total contract price | 24000 |
| Work certified | 12500 |
| Work not certified | 2500 |
| Estimated further cost to completion of work | 17500 |
| Progress payment received | 11000 |
| Progress payment to be received | 3000 |

Applying the provisions of AS 7, you are required to compute:

(i) Profit/Loss for the year ended 31st March, 2023

(ii) Contract work in progress at the end of financial year 2022-2023

(iii) Revenue to be recog!lized out of the total contract value-

(iv) Amount due from/to customers as at the year end

(*G-II, May, 2023*) (*5 Marks*)

CHAPTER 21

# Accounting Standard 9 Revenue Recognition

## Question 1

*Zigato runs a food-delivery business. As per the arrangement, Zigato allows customers to order food from local restaurants and is responsible the delivery of the food within stipulated time. During a particular year, it collects the money on orders made online as under:*

| | | |
|---|---|---|
| *Total price for the food item* | - | *₹ 200 lakhs* |
| *Delivery charges* | - | *₹ 60 lakhs* |
| *GST -* | - | *₹ 40 lakhs* |
| *Total-* | - | *₹ 300 lakhs* |

*Zigato has received ₹ 300 lakhs for the above orders from customers and the orders were delivered to the customer in stipulated time.*

*How much revenue should be recognised by restaurants and how much revenue should be recognised by Zigato for the year?*

(*Source: Illustration 1, Study Material*)

**Answer**

The risks and rewards associated with the food item are not with Zigato. When a customer has ordered a food item, whether the item will be prepared or not is the responsibility of the restaurant and not Zigato. Similarly, the responsibility to deliver the food item is with Zigato and the restaurant does not undertake responsibility for the same.

Therefore, the restaurant undertakes the principal's responsibility to prepare the food and ensure its quality. Zigato, on the other hand, is only responsible to deliver the food. Thus, Zigato is acting as an agent. Hence, it can only recognize revenue relating to that activity (which it does in the ordinary course of business). The revenue for Zigato, therefore, is ₹ 60 lakhs, whereas, the revenue for restaurants will be ₹ 200 lakhs.

It may be noted that the GST of ₹ 40 lakhs is a liability payable to the Government (third party), hence it does not form part of revenue.

## Question 2

*AB sells goods to CD on 1st March 20X1. CD is having significant cash flows issues since last few months. However, it is trying to raise funding through bank loan to be able to run its operations in future. On 5th of May 20X1, CD is able to seek the funding and is expected to be able to pay for the goods in future.*

*At the time of sale, it is difficult for AB to ascertain whether it will be able to collect the amount from CD due to poor financial conditions.*

*Explain how the recognition of revenue be done by AB?*

(*Source: Illustration 2, Study Material*)

**Answer**

In the above case, AB should not recognise any revenue on 1st of March and until that uncertainty of recovery is clear. Hence, the revenue can only be recognised by AB on 5th of May 20X1. The inventory transferred to CD until that date is required to be shown as its own inventory [inventory lying with customers].

## Question 3

*AB sells goods to CD on 1st January 20X1 for ₹ 2 lakhs. After the sale was made, CD is having significant cash flows issues. It is trying to raise funding through bank loan to be able to run its operations in future. However, it is unable to do so and has gone under liquidation on 15th of March 20 X1.*

*At the time of sale, there was no reason for AB to believe that it will not be able to collect the amount from CD in future.*

*Explain how the recognition of revenue be done by AB for the year ended 31st March 20X1?*

(*Source: Illustration 3, Study Material*)

**Answer**

In the above case, at the time of sale, it was not unreasonable for AB to expect ultimate collection from CD. Therefore, AB should recognise the revenue of ₹ 2 lakhs on 1st of January 20X1 and recognise a receivable for the same amount.

Later, since CD went into liquidation, AB should write off the receivables and book a loss in his books.

Accounting in the books of AB 1st January 20X1

| | | | |
|---|---|---|---|
| CD A/c (Receivables)<br>To Revenue A/c (Being goods sold to CD Ltd) | Dr. | ₹ 2 lakhs | <br>₹ 2 lakhs |

15th March 20X1

| | | | |
|---|---|---|---|
| Bad Debts A/c<br>To CD A/c (Receivables)A/c<br>(Being receivables from CD written off due to its liquidation) | Dr. | ₹ 2 lakhs | <br>₹ 2 lakhs |

## Question 4

*During the year ended 31st March 20X1, ZX Enterprises has recognized ₹ 100 lakhs on accrual basis income from dividend on units of mutual funds held by it. The dividends on mutual funds were declared on 15th June, 20X1. The dividend was proposed on 10th April, 20X1.*

*Whether the above treatment is as per the relevant Accounting Standard?*

(*Source: Illustration 4, Study Material*)

**Answer**

Dividends from investments in shares are not recognized in the statement of profit and loss until a right to receive payment is established. In the given situation, the dividend is proposed on 10th April, 20X1, while it is declared on 15th June, 20X1. Thus, the right to receive the payment of dividend gets established on 15th June, 20X1.

The recognition of ₹ 100 lakhs on accrual basis in the financial year 20X0-20X1 is not correct as per AS 9 'Revenue Recognition'.

## Question 5

*Y Ltd., used certain resources of X Ltd. In return X Ltd. received ₹ 10 lakhs and ₹ 15 lakhs as interest and royalties respective from Y Ltd. during the year 20 X1-X2. You are required to state whether and on what basis these revenues can be recognized by X Ltd.*

(*Source: Illustration 5, Study Material*)

**Answer**

As per AS 9 on Revenue Recognition, revenue arising from the use by others of enterprise resources yielding interest and royalties should only be recognized when no significant uncertainty as to measurability or collectability exists. These revenues are recognized on the following bases:

(i) Interest: on a time proportion basis taking into account the amount outstanding and the rate applicable. Therefore X Ltd. should recognize interest revenue of ₹ 10 Lakhs

(ii) Royalties: on an accrual basis in accordance with the terms of the relevant agreement. X Ltd. therefore should recognize royalty revenue of ₹ 15 Lakhs.

## Question 6

On 1st January 20X1, M/s KJ sells goods at invoice value of ₹ 5 lakhs to M/s TH. At the time of sale, M/s KJ has agreed to repurchase these goods back from M/s TH on 31st March at a price of ₹ 6 Lac.

You are required to do the accounting for above transactions in the books of M/s KJ.

(*Source: Example 7, Study Material*)

**Answer**

1st Jan 20X1:

| | | | |
|---|---|---|---|
| Bank A/c<br>To Loan from M/s TH A/c<br>(Being borrowing made under the Sale & Repurchase arrangement) | Dr. | ₹5 lakhs | <br>₹5 lakhs |

31st March 20X1

| | | | |
|---|---|---|---|
| Interest expense A/c<br>To Loan from M/s TH A/c<br>(Being interest cost recognised on the borrowing) | Dr. | ₹1 lakhs | <br><br>₹1 lakhs |

31st March 20X1:

| | | | |
|---|---|---|---|
| Loan from M/s TH A/c To Bank A/c<br>(Being repayment of loan taken from TH) | Dr. | ₹6 lakhs | <br>₹6 lakhs |

## Question 7

*In the year 20X1-X2, XYZ supplied goods on Consignment basis to ABC – a retail outlet worth ₹ 10,00,000. As per the terms, ABC will only pay XYZ for the goods which are sold by them to the third party. Rest of the goods can be returned back to XYZ and ABC will not have any further liability for these goods.*

*During the year 20X1-X2, ABC has sold goods worth ₹ 5,50,000 only and rest of the goods are still lying in its store which may get sold by next year. Advise XYZ, how much revenue it can recognize in its books for period 20X1-X2.*

**Answer**

As per AS 9, consignment risk and rewards are not transferred to the customer on just delivery of the goods and no revenue should be recognized until the goods are sold to a third party. Therefore, XYZ can recognize revenue of ₹ 5,50,000 only.

## Question 8

*The Board of Directors decided on 31.3.20X2 to increase the sale price of certain items retrospectively from 1st January, 20X2. In view of this price revision with effect from 1st January 20X2, the company has to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2.*

*Accountant cannot make up his mind whether to include ₹ 15 lakhs in the sales for 20X1-20X2.Advise.*

(*Source: Illustration 6, Study Material*)

**Answer**

Price revision was effected during the current accounting period 20 X1-20X2. As a result, the company stands to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2. If the company is able to assess the ultimate collection with reasonable certainty, only then additional revenue arising out of the said price revision may be recognized in 20X1-20X2.

If the company is not reasonably certain on ultimate collection ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2, it shall postpone recognition of revenue and disclose it in financial statements for year 20X1-20X2 as per AS 1

## Question 9

*A claim lodged with the Railways in March, 20X1 for loss of goods of ₹ 2,00,000 had been passed for payment in March, 20X3 for ₹ 1,50,000. No entry was passed in the books of the Company, when the claim was lodged. Advise P Co. Ltd. about the treatment of the following in the Final Statement of Accounts for the year ended 31st March, 20X3.*

(*Source: Illustration 7, Study Material*)

**Answer**

AS 9 on 'Revenue Recognition' states that where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is certain to be collected. In this case it may be assumed that collectability of claim was not certain in the earlier periods. This is supposed from the fact that only ₹ 1,50,000 were collected against a claim of ₹ 2,00,000. So this transaction can not be taken as a Prior Period Item.

Hence receipt of ₹ 1,50,000 shall be recognized as revenue in year ended 31st March, 20X3

In the light of AS 5, it will not be treated as extraordinary item. However, AS 5 states that when items of income and expense within profit or loss from ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately.

## Question 10

*GH manufactures and sells televisions. The televisions are shipped to the customer by sea. In order to transfer risk related to the shipment of the televisions, GH also gets an insurance coverage for the goods while they are in transit from the factory to customer's location.*

*The insurance policy will reimburse GH for the value of the goods in the event of loss or damage arising anytime up to these goods reaching customer's location. The legal title passes when the goods arrive at the customer's premises one month later.*

*When should Entity GH recognize revenue in its books?*

(*Source: Practical Question 6, Study Material*)

**Answer**

GH should recognize revenue for the sale when the goods arrive at the customer's premises. GH has not transferred the televisions' significant risks and rewards of ownership to the customer when the goods depart from the factory. This is evidenced by the fact that any insurance proceeds received from the goods' damage or destruction will be repaid to GH. Further, the legal title does not pass until the goods arrive at the customer's premises.

## Question 11

*The following information of Meghna Ltd. is provided:*

(i) *Goods of ₹ 60,000 were sold on 20-3-20X2 but at the request of the buyer these were delivered on 10-4-20X2.*

(ii) *On 15-1-20X2 goods of ₹ 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-20X2.*

(iii) *₹ 1,20,000 worth of goods were sold on approval basis on 1 -12-20X1. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-20X2 and no approval or disapproval received for the remaining goods till 31 -3- 20X2.*

(iv) *Apart from the above, the company has made cash sales of ₹ 7,80,000 (gross). Trade discount of 5% was allowed on the cash sales.*

*You are required to advise the accountant of Meghna Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS 9.*

(*Source: Practical Question 7, Study Material*)

**Answer**

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Case (i) The sale is complete but delivery has been postponed at buyer's request. The entity should recognize the entire sale of ₹ 60,000 for the year ended 31st March, 20X2.

Case (ii) 20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 1,20,000 (80% of ₹ 1,50,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

Case (iii) In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the ₹ 90,000 upon receipt of approval on 31-02-20X1 and for the balance ₹ 30,000 on 01-03- 20X1 as the time period for rejecting the goods had expired.

Case (iv) Trade discounts given should be deducted in determining revenue. Thus ₹ 39,000 should be deducted from the amount of turnover of ₹ 7,80,000 for the purpose of recognition of revenue.

Thus, revenue should be ₹ 7,41,000.

## Question 12

*For the year ended 31st March 20X1, KY Enterprises has entered into the following transactions.*

*On 31 March 20X1, KY supplied two machines to its customer ST. Both machines were accepted by ST on 31 March 20X1. Machine 1 was a machine that was routinely supplied by KY to many customers and the installation process was very simple.*

*Machine 1 was installed on 2 April 20X1 by ST's employees.*

*Machine 2 being more specialised in nature requires an installation process which is more complicated, requiring significant assistance from KY. Machine 2 was installed between 2 and 5 April 20X1. Details of costs and sales prices are as follows:*

| | *Machine 1* | *Machine 2* |
|---|---|---|
| *Sale Price* | *3,20,000* | *3,00,000* |
| *Cost of production* | *1,60,000* | *1,50,000* |
| *Installation fee* | *nil* | *10,000* |

*How should above transactions be recognized by KY Enterprises for the year ended 31st March 20X1?*

(*Source: Practical Question 8, Study Material*)

**Answer**

**Machine 1:** As the installation process is simple, revenue from Machine 1 will be recognized on 31 March 20X1.

| | |
|---|---|
| Revenue (Machine 1) | ₹ 3,20,000 |
| Cost of Goods Sold | ₹ 1,60,000 |
| Profit during the period | ₹ 1,60,000 |

Since the question specifies that the machine is already accepted by ST on 31 March 20X1, the revenue arising from sale of the machine needs to be recognized for the year ending 31 March 20X1. This is because acceptance of the machine indicates that the risks and rewards pursuant to the ownership are transferred to ST.

**Machine 2**: Installation process for Machine 2 is more complicated, requiring significant assistance from KY Ltd. However, question specifies that the machine is already accepted by ST on 31 March 20X1. Assuming that there is no further approval/acceptance required from the buyer for the Machine sold, revenue from sale of Machine 2 can be recognized for the year ending 31 March 20X1.

| | |
|---|---|
| Revenue (Machine 2) | ₹ 3,00,000 |
| Cost of Goods Sold | ₹ 1,50,000 |
| Profit during the period | ₹ 1,50,000 |

However, installation fee which is for rendering installation services cannot be recognized until the installation is complete. Since the machine is pending installation, the revenue in respect of installation charges ₹10,000 needs to be recognized on 5 April 20X1 once the installation process gets completed.

# QUESTION BANK

## Question 13

Sarita Publications publishes a monthly magazine on the 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The sale of space for the March 2014 issue was made in February 2014. The magazine was published on its scheduled date. It received ₹ 2,40,000 on 10.3.2014 and ₹ 60,000 on 10.4.2014 for the March 2014 issue.

Discuss in the context of AS 9 the amount of revenue to be recognized and the treatment of the amount received from advertisers for the year ending 31.3.2014. What will be the treatment if the publication is delayed till 2.4.2014?

(*November 2014, 5 Marks*)

**Answer**

As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method as the service is performed, whichever relates the revenue to the work accomplished.

In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is seen by public and hence revenue is recognized on that date. In this case, it is 15.03.2014, the date of publication of the magazine.

Hence, ₹ 3,00,000 (₹ 2,40,000 + ₹ 60,000) is recognized as income in March, 2014. The terms of payment are not relevant for considering the date on which revenue is to be recognized. ₹ 60,000 is treated as amount due from advertisers as on 31.03.2014 and ₹ 2,40,000 will be treated as payment received against the sale.

However, if the publication is delayed till 02.04.2014 revenue recognition will also be delayed till the advertisements get published in the magazine. In that case revenue of ₹ 3,00,000 will be recognized for the year ended 31.03.2015 after the magazine is published on 02.04.2014**.** The amount received from sale of advertising space on 10.03.2014 of ₹ 2,40,000 will be considered as an advance from advertisers as on 31.03.2014.

## Question 14

Given the following information of M/s. Paper Products Ltd.

(i) Goods of ₹ 60,000 were sold on 20-3-2015 but at the request of the buyer these were delivered on 10-4-2015.

(ii) On 15-1-2015 goods of ₹ 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-2015.

(iii) ₹ 1,20,000 worth of goods were sold on approval basis on 1-12-2014. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-2015 and no approval or disapproval for the remaining goods till 31-3-2015.

(iv) Apart from the above, the company has made cash sales of ₹ 7,80,000 (gross). Trade discount of 5% was allowed on the cash sales.

You are required to advise the accountant of M/s. Paper Products Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS-9 and also determine the total revenue to be recognized for the year ending 31-3-2015.

(*May 2015, 4 Marks*)

**Answer**

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

<u>In case (i):</u>

The sale is complete but delivery has been postponed at buyer's request. M/s Paper Products Ltd. should recognize the entire sale of ₹ 60,000 for the year ended 31st March, 2015.

<u>In case (ii):</u>

20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 1,20,000 (80% of ₹ 1,50,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

<u>In case (iii):</u>

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, in case (iii) revenue should be recognized for the total sales amounting ₹ 1,20,000 as the time period for rejecting the goods had expired.

In case (iv):

Trade discounts given should be deducted in determining revenue. Thus ₹ 39,000 should be deducted from the amount of turnover of ₹ 7,80,000 for the purpose of recognition of revenue. Thus, revenue should be ₹ 7,41,000.

Thus total revenue amounting ₹ 10,41,000 (60,000 + 1,20,000+ 1,20,000+7,41,000) will be recognized for the year ended 31st March, 2015 in the books of M/s Paper Products Ltd.

## Question 15

M/s Umang Ltd. sold goods through its agent. As per terms of sales, consideration is payable within one month. In the event of delay in payment, interest is chargeable @ 12% p.a. from the agent. The company has not realized interest from the agent in the past. For the year ended 31st March, 2015 interest due from agent (because of delay in payment) amounts to ₹ 1,72,000. The accountant of M/s Umang Ltd. booked ₹ 1,72,000 as interest income in the year ended 31st March, 2015. Discuss the contention of the accountant with reference to Accounting Standard-9.

(*November 2015, 5 Marks*)

**Answer**

As per para 9.2 of AS 9 "Revenue Recognition", "where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty involved. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made".

In this case, the company never realized interest for the delayed payments made by the agent. Hence, based on the past experience, the realization of interest for the delayed payments by the agent is very much uncertain. The interest should be recognized only if the ultimate collection is certain. Therefore, the interest income of ₹ 1,72,000 should not be recognized in the books for the year ended 31st March, 2015. Thus the contention of accountant is incorrect.

However, if the agents have agreed to pay the amount of interest and there is an element of certainty associated with these receipts, the accountant is correct regarding booking of ₹ 1,72,000 as interest amount.

## Question 16

A manufacturing company has the following stages of production and sale in manufacturing Fine paper rolls:

| Date | Activity | Costs to Date (₹) | Net Realizable Value (₹) |
|---|---|---|---|
| 15.1.16 | Raw material | 1,00,000 | 80,000 |
| 20.1.16 | Pulp (WIP 1) | 1,20,000 | 1,20,000 |
| 27.1.16 | Rough & thick paper (WIP 2) | 1,50,000 | 1,80,000 |
| 15.2.16 | Fine Paper Rolls | 1,80,000 | 3,50,000 |
| 20.2.16 | Ready for sale | 1,80,000 | 3,50,000 |
| 15.3.16 | Sale agreed and invoice raised | 2,00,000 | 3,50,000 |
| 02.4.16 | Delivered and paid for | 2,00,000 | 3,50,000 |

Explain the stage on which you think revenue will be generated and state how much would be net profit for year ending 31-3-16 on this product according to AS-9.

(*Group I, November 2016, 5 Marks*)

**Answer**

According to AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Thus, sales will be recognized only when following two conditions are satisfied:

(i) The sale value is fixed and determinable.

(ii) Property of the goods is transferred to the customer.

Both these conditions are satisfied only on 15.3.2016 when sales are agreed upon at a price and goods are allocated for delivery purpose through invoice. The amount of net profit ₹ 150,000 (3,50,000 – 2,00,000) would be recognized in the books for the year ending 31st March, 2016.

## Question 17

Ruby Ltd. sold goods through its agent. As per terms of sales, consideration is payable within one month. In the event of delay in payment, interest is chargeable @ 10% p.a. from the agent. The company has not realized interest from the agent in the past. For the year ended 31st March, 2017 interest due from agent (because of delay in payment) amounts to ₹5 lakhs. The accountant of Ruby Ltd. booked ₹5 lakhs as interest income in the year ended 31st March, 2017.

Examine and discuss the contention of the accountant with reference to AS 9 "Revenue Recognition".

(*MTP April/October 2018 & April 2019*) (*5 Marks*)

**Answer**:

As per AS 9 "Revenue Recognition", "where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty involved. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made". In this case, the company never realized interest for the delayed payments made by the agent. Hence, based on the past experience, the realization of interest for the delayed payments by the agent is very much uncertain. The interest should be recognized only if the ultimate collection is certain. Therefore, the interest income of ₹5 lakhs should not be recognized in the books for the year ended 31st March, 2017. Thus the contention of accountant is incorrect. However, if the agents have agreed to pay the amount of interest and there is an element of certainty associated with these receipts, the accountant is correct regarding booking of ₹5 lakhs as interest amount.

## Question 18

Fashion Limited is engaged in manufacturing of readymade garments. They provide you the following information on 31st March, 2017:

(i) On 15th January, 2017 garments worth ₹4,00,000 were sent to Anand on consignment basis of which 25% garments unsold were lying with Anand as on 31st March, 2017.

(ii) Garments worth ₹1,95,000 were sold to Shine boutique on 25th March, 2017 but at the request of Shine Boutique, these were delivered on 15th April, 2017.

(iii) On 1st November, 2016 garments worth ₹2,50,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods up to 31st December, 2016 and no approval or disapproval received for the remaining goods till 31st March, 2017.

You are required to advise the accountant of Fashion Limited, the amount to be recognised as revenue in above cases in the context of AS 9

(*RTP November 2018*)

**Answer**:

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

**Case (i)**: 25% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹3,00,000 (75% of ₹4,00,000) for the year ended on 31.3.17. In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

**Case (ii)**: The sale is complete but delivery has been postponed at buyer's request. Fashion Ltd. should recognize the entire sale of ₹1,95,000 for the year ended 31st March, 2017.

**Case (iii)**: In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹2,50,000 as the time period for rejecting the goods had expired.

Thus total revenue amounting ₹7,45,000 (3,00,000+1,95,000+2,50,000) will be recognized for the year ended 31st March, 2017 in the books of Fashion Ltd.

## Question 19

Raj Ltd. entered into an agreement with Heena Ltd. to dispatch goods valuing ₹5,00,000 every month for next 6 months on receipt of entire payment. Heena Ltd. accordingly made the entire payment of ₹30,00,000 and Raj Ltd. started dispatching the goods. In fourth month, due to fire in premise of Heena Ltd., Heena Ltd. requested to Raj Ltd. not to dispatch goods worth ₹15,00,000 ready for dispatch. Raj Ltd. accounted ₹15,00,000 as sales and transferred the balance to Advance received against Sales account.

Comment upon the above treatment by Raj Ltd. with reference to the provision of AS-9.

(*RTP May, 2019*)

**Answer:**

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

In the given case, transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. Also, the sale price has been recovered by the seller. Hence, the sale is complete but delivery has been postponed at buyer's request. Raj Ltd. should recognize the entire sale of ₹30,00,000 (₹5,00,000 × 6) and no part of the same is to be treated as Advance Received against Sales.

## Question 20

Given below are the following informations of M/s B.S. Ltd.

(i) Goods of ₹50,000 were sold on 18-03-2018 but at the request of the buyer these were delivered on 15-04-2018.

(ii) On 13-01-2018 goods of ₹1,25,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-03-2018.

(iii) ₹1,00,000 worth of goods were sold on approval basis 01-12-2017. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-01-2018 and no approval or disapproval received for the remaining goods till 31-03-2018.

You are required to advise the accountant of M/s B.S. Ltd., with valid reasons, the amount to be recognized as revenue for the year ended 31st March, 2018 in above cases in the context of AS-9.

(*May 2019*) (*5 Marks*)

**Answer:**

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

**Case (i)**

The sale is complete but delivery has been postponed at buyer's request. B.S. Ltd. should recognize the entire sale of ₹50,000 for the year ended 31st March, 2018.

**Case (ii)**

In case of consignment sale revenue should not be recognized until the goods are sold to a third party. 20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹1,00,000 (80% of ₹1,25,000).

**Case (iii)**

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹1,00,000 as the time period for rejecting the goods had expired.

Thus total revenue amounting ₹2,50,000 (50,000 + 1,00,000+ 1,00,000) will be recognized for the year ended 31st March, 2018 in the books of B.S. Ltd.

## Question 21

The Board of Directors decided on 31.3.2019 to increase the sale price of certain items retrospectively from 1st January, 2019. In view of this price revision with effect from 1st January 2019, the company has to receive ₹15 lakhs from its customers in respect of sales made from 1st January, 2019 to 31st March, 2019. Accountant cannot make up his mind whether to include ₹15 lakhs in the sales for 2018-2019. Advise.

(*RTP November 2019*)

**Answer:**

Price revision was effected during the current accounting period 2018-2019. As a result, the company stands to receive ₹15 lakhs from its customers in respect of sales made from 1st January, 2019 to 31st March, 2019. If the company is able to assess the ultimate collection with reasonable certainty, then additional revenue arising out of the said price revision may be recognised in 2018-2019 vide para 10 of AS 9.

## Question 22

Indicate in each case whether revenue can be recognized and when it will be recognized as per AS-9.

(1) Trade discount and volume rebate received.

(2) Where goods are sold to distributor or others for resale.

(3) Where seller concurrently agrees to repurchase the same goods at a later date.

(4) Insurance agency commission for rendering services.

(5) On 11-03-2019 cloths worth ₹50,000 were sold to X mart, but due to refurbishing of their showroom being underway, on their request cloths were delivered on 12-04-2019.

(*November 2019, New Course, 5 Marks*)

**Answer**

(1) Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

(2) When goods are sold to distributor or others, revenue from such sales can generally be recognized if significant risks of ownership have passed; however, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

(3) For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue.

(4) Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

(5) On 11.03.2019, if X mart takes title and accepts billing for the goods then it is implied that the sale is complete and all risk and reward on ownership has been transferred to the buyers.

Revenue should be recognized for year ended 31st March, 2019 notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made and items were ready for delivery to the buyer at the time.

## Question 23

Fashion Limited is engaged in manufacturing of readymade garments. They provide you the following information on 31st March, 2019:

(i) On 15th January, 2019 garments worth ₹ 4,00,000 were sent to Anand on consignment basis of which 25% garments unsold were lying with Anand as on 31st March, 2019.

(ii) Garments worth ₹ 1,95,000 were sold to Shine boutique on 25th March, 2019 but at the request of Shine Boutique, these were delivered on 15th April, 2019.

You are required to advise the accountant of Fashion Limited, the amount to be recognised as revenue in above cases in the context of AS 9 .

(*RTP, November, 2020*)

**Answer**

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

**Case (i):** 25% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 3,00,000 (75% of ₹ 4,00,000) for the year ended on 31.3.19. In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

**Case (ii):** The sale is complete but delivery has been postponed at buyer's request. Fashion Ltd. should recognize the entire sale of ₹1,95,000 for the year ended 31st March, 2019.

## Question 24

Tonk Tanners is engaged in manufacturing of leather shoes. They provide you the following information for the year ended 31st March, 2020:

(i) On 31st December, 2019 shoes worth ₹ 3,20,000 were sent to Mohan Shoes for sale on consignment basis of which 25% shoes were unsold and lying with Mohan Shoes as on 31st March, 2020.

(ii) On 10th January, 2020, Tonk Tanner supplied shoes worth ₹ 4,50,000 to Shani Shoes and concurrently agrees to re-purchase the same goods on 11th April. 2020.

(iii) On 21st March, 2020 shoes worth ₹ 1,60,000 were sold to Shoe Shine but due to refurbishing of their showroom being underway, on their request, shoes were delivered on 12th April, 2020.

You are required to advise the accountant of Tonk Tanners, when amount is to be recognised as revenue in 2019 -20 in above cases in the context of AS 9.

(*RTP, May, 2021*)

**Answer**

**(i) Shoes sent to Mohan Shoes (consignee) for consignment sale**

In case goods are sent for consignment sale, revenue is recognized when significant risks of ownership have passed from seller to the buyer.

In the given case, Mohan Shoes is the consignee i.e. an agent of Tonk Tanners and not the buyer. Therefore, the risk and reward is considered to vest with Tonk Tanners only till the time the sale is made to the third party by Mohan Shoes; although the goods are held by Mohan Shoes. Hence, in the year 2019- 2020, the sale will be recognized for the amount of goods sold by Mohan Shoes to the third party i.e. for ₹ 3,20,000 x 75% = ₹ 2,40,000.

**(ii) Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date**

For such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue and should not be recognised as revenue in the year 2019-2020. Hence, sale of ₹ 4,50,000 to Shani Shoes should not be recognized as revenue.

**(iii) Delivery is delayed at buyer's request**

On 21st March, 2020, if Shoe Shine takes title and accepts billing for the goods then it is implied that the sale is complete and all the risk and rewards of ownership has been transferred to the buyer. In case no significant uncertainty exists regarding the amount of consideration for sale, revenue shall be recognized in the year 2019-2020 irrespective of the fact that the delivery is delayed on the request of Shoe Shine.

## Question 25

Old Era Publication Publishes a popular monthly magazine on 15th of every month. The publication sells the advertising space on terms of 90% payable in advance and the balance 10% payable within 30 days of release of the publication. The space for March 2020 issue of the magazine was sold in the month of February, 2020. The magazine was published as per schedule on 15th of the month. The amount of ₹ 2,70,000 has been received upto 31st March, 2020 and ₹ 30,000 was received on 10th April, 2020 for advertisement published in the March issue of the publication.

Please advise the accountant the amount of revenue to be recognized in the context of the provisions of AS 9 'Revenue Recognition' during the year ending on 31st March, 2020.

(*MTP*, *October 2021*) (*5 Marks*)

**Answer**

**Definition:** As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished.

**Analysis of given case:** In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is appeared for public and hence revenue is recognized on that date. In this case, it is 15.03.2020, the date of publication of the magazine.

**Accounting treatment for given situation:** Hence, ₹ 3,00,000 (₹ 2,70,000 + ₹ 30,000) is recognized as income in March, 2020. The terms of payment are not relevant for considering the date on which revenue is to be recognized. ₹ 30,000 is treated as amount due from advertisers as on 31.03.2020 and ₹ 2,70,000 will be treated as payment received against the sale.

## Question 26

(a) An infrastructure company has constructed a mall and entered into agreement with tenants towards license fee (monthly rental) and variable license fee, a percentage on the turnover of the tenant (on an annual basis). Chief Financial Officer of the company wants to account/recognize license fee as income for 12 months during current year and variable license fee as income during next year, since invoice is raised in the subsequent year. Comment whether the treatment desired by the CFO is correct or not.

(b) Indicate in each case whether revenue can be recognized and when it will be recognized as per AS 9.

(1) Trade discount and volume rebate received.

(2) Where goods are sold to distributors or others for resale.

(3) Where seller concurrently agrees to repurchase the same goods at a later date.

(4) Insurance agency commission for rendering services.

(*RTP May, 2022*)

**Answer**

**(a)** AS 9 on Revenue Recognition, is mainly concerned with the timing of recognition of revenue in the Statement of Profit and Loss of an enterprise. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. However, when uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition. Further, as per accrual concept, revenue should be recognized as and when it is accrued i.e. recorded in the financial statements of the periods to which they relate. In the present case, monthly rental towards license fee and variable license fee as a percentage on the turnover of the tenant (though on annual basis) is the income related to common financial year.

Therefore, recognizing the fee as revenue cannot be deferred simply because the invoice is raised in subsequent period. Hence it should be recognized in the financial year of accrual. Therefore, the contention of the Chief Financial Officer is not in accordance with AS 9.

**(b)** (1) Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

(2) When goods are sold to distributor or others, revenue from such sales can be recognized if significant risks of ownership have passed; however, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

(3) For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue.

(4) Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

## Question 27

(a) How will you recognize revenue in the following cases:

1. Installation Fees;
2. Advertising and insurance agency commissions;
3. Subscriptions for publications.

(b) Shipra Ltd., has been successful jewellers for the past 100 years and sales are against cash only (returns are negligible). The company also diversified into apparels. A young senior executive was put in charge of Apparels business and sales increased 5 times. One of the conditions for sales is that dealers can return the unsold stocks within one month of the end of season. Sales return for the year was 25% of sales. Suggest a suitable Revenue Recognition Policy, with reference to AS 9.

(*RTP November 2021*)

**Answer**

**(a)** **Installation Fees**: In cases where installation fees are other than incidental to the sale of a product, they should be recognized as revenue only when the equipment is installed and accepted by the customer.

**Advertising and insurance agency commissions**: Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed. Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

**Subscription for publications**: Revenue received or billed should be deferred and recognized either on a straight-line basis over time or, where the items delivered vary in value from period to period, revenue should be based on the sales value of the item delivered in relation to the total sales value of all items covered by the subscription.

**(b)** As per AS 9 “Revenue recognition”, revenue recognition is mainly concerned with the timing of recognition of revenue in statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

**Effect of Uncertainty**- In the case of the jewellery business the company is selling for cash and returns are negligible. Hence, revenue can be recognized on sales. On the other hand, in Apparels Industry, the dealers have a right to return the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 25% of its sales. The company may disclose suitable revenue recognition policy in its financial statements separately for both Jewellery and Apparels business.

## Question 28

Given the following information of Rainbow Ltd.

(i) On 15th November, goods worth ₹ 5,00,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods sold upto 31st January and no approval or disapproval received for the remaining goods till 31st March.

(ii) On 31st March, goods worth ₹ 2,40,000 were sold to Bright Ltd. but due to refurnishing of their show-room being underway, on their request, goods were delivered on 10th April.

(iii) Rainbow Ltd. supplied goods worth ₹ 6,00,000 to Shyam Ltd. and concurrently agrees to re-purchase the same goods on 14th April.

(iv) Dew Ltd. used certain assets of Rainbow Ltd. Rainbow Ltd. received ₹ 7.5 lakhs and ₹ 12 lakhs as interest and royalties respectively from Dew Ltd. during the year·2020-21.

(v) On 25th December goods of ₹ 4,00,000 were sent on consignment basis of which 40% of the goods unsold are lying with the consignee at the year end on 31st March.

In each of the above cases, you are required to advise, with valid reasons, the amount to be recognized as revenue under the provisions of AS-9.

(*Question Paper of December 2021*) *(5 Marks)*

**Answer:**

(i) As per AS 9 “Revenue Recognition”, in case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹ 5,00,000 as the time period for rejecting the goods had expired.

(ii) The sale is complete but delivery has been postponed at buyer’s request. The entity should recognize the entire sale of ₹ 2,40,000 for the year ended 31st March.

(iii) Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date, such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue. Hence no revenue to be recognized in the given case.

(iv) Revenue arising from the use by others of enterprise resources yielding interest and royalty should be recognized when no significant uncertainty as to measurability or collectability exists. The interest should be recognized on time proportion basis taking into account the amount outstanding and rate applicable. The royalty should be recognized on accrual basis in accordance with the terms of relevant agreement.

(v) 40% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 2,40,000 (60% of ₹ 4,00,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

## Question 29

*Indicate in each case whether revenue can be recognized and when it will be recognized as per AS-9.*

*(i) Delivery is delayed at buyer's request but buyer takes title and accepts billing.*

*(ii) Instalment Sales.*

*(iii) Trade discounts and volume rebates.*

*(iv) Insurance agency commission for rendering services.*

*(v) Advertising commission.*

**Answer**

**(i) Delivery is delayed at buyer's request and buyer takes title and accepts billing:** Revenue should be recognized notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made. However, the item must be on hand, identified and ready for delivery to the buyer at the time the sale is recognized rather than there being simply an intention to acquire or manufacture the goods in time for delivery.

**(ii) Instalment sales:** When the consideration is receivable in instalments, revenue attributable to the sales price exclusive of interest should be recognized at the date of sale. The interest element should be recognized as revenue, proportionately to the unpaid balance due to the seller.

**(iii) Trade discounts and volume rebates:** Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

**(iv) Insurance agency commissions for rendering services:** Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

**(v) Advertising commission:** Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed.

## Question 30

When revenue will be recognized in the following situation:

(i) Where the purchaser makes a series of installment payments to the seller and the seller deliver the goods only when the final payment is received.

(ii) Where seller concurrently agrees to repurchase the same goods at a later date.

(iii) Where goods are sold to distributors, dealers or others for resale.

(iv) Commissions on service rendered as agent on insurance business.

(*RTP November, 2022*)

**Answer**

(i) Revenue from sales where the purchaser makes a series of instalment payments to the seller, and the seller delivers the goods only when the final payment is received, should not be recognised until goods are delivered. However, when experience indicates that most such sales have been consummated, revenue may be recognised when a significant deposit is received.

(ii) For sale where seller concurrently agrees to repurchase the same goods at a later date, such transactions are in substance a financing agreement. In such a situation, the resulting cash inflow should not be recognised as revenue.

(iii) Revenue from sales of goods to distributors, dealers or others for resale can generally be recognised if significant risks of ownership have passed. However, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

(iv) Commissions on service rendered as agent on insurance business should be recognised as revenue when the service is completed. Insurance agency commissions should be recognised on the effective commencement or renewal dates of the related policies.

## Question 31

PQR Ltd., sells agriculture products to dealers. One of the conditions of sale is that interest is at the rate of 2% p.m., for delayed payments. Percentage of interest recovery is only 10% on such overdue outstanding due to various reasons. During the year 2021-22 the company wants to recognize the entire interest receivable. Do you agree?

(*RTP May, 2023*)

**Answer**

As per AS 9 'Revenue Recognition', where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g. for escalation of price, export incentives, interest etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.

Thus, PQR Ltd. cannot recognise the interest amount unless the company actually receives it. 10% rate of recovery on overdue outstanding is also an estimate based on previous record and is not certain. Hence, the company is advised to recognise interest receivable only on receipt basis.

## Question 32

Toy Ltd. is engaged in manufacturing toys. They provide you the following information as on 31st March, 2023 :

(i) On 15th January, 2023, Toys worth ₹ 5,00,90 were sent to A Ltd. on consignment basis of which 25% Toys unsold were lying with A Ltd. as on 31st March, 2023:

(ii) Toys worth ₹ 2,25,000 were sold to S Ltd. on 25th March, 2023 but at the request of S Ltd., these were delivered on 15th April, 2023.

(iii) On 1st November, 2022, toys worth ₹3,50,000 were sold on approval basis. The period of approval was 4 months' after which they were considered sold. Buyer sent approval for 5% goods upto 31st December, 2022 and no approval or disapproval received for the remaining goods till 31st March, 2023:

You are required to advise the accountant of Toy Ltd., the amount to be recognised as revenue in above cases in the context of AS-9

(*G-II, May, 2023*) (*5 Marks*)

CHAPTER

# 22

# Accounting Standard 14
# Accounting for Amalgamations

## Question 1

*A Ltd. take over B Ltd. on April 01, 20X1 and discharges consideration for the business as follows:*

*(i) Issued 42,000 fully paid equity shares of ₹ 10 each at par to the equity shareholders of B Ltd.*

*(ii) Issued fully paid up 15% preference shares of ₹ 100 each to discharge the preference shareholders (₹ 1,70,000) of B Ltd. at a premium of 10%.*

*(iii) It is agreed that the debentures of B Ltd. (₹ 50,000) will be converted into equal number and amount of 13% debentures of A Ltd.*

*Determine the amount of purchase consideration as per AS 14.*

(*Source: Illustration 1, Study Material*)

**Answer**

| **Particulars** | ₹ |
|---|---|
| Equity Shares (42,000 x 10) | 4,20,000 |
| 15% Preference Share Capital | 1,70,000 |
| *Add:* Premium on Redemption | 17,000 |
| Purchase Consideration | 6,07,000 |

**Note:** As per AS 14, consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. Thus, payment to debenture holders are not covered by the term 'consideration'.

## Question 2

*A Ltd. and B Ltd. were amalgamated on and from 1st April, 20X1. A new company C Ltd. was formed to take over the business of the existing companies. A Ltd. and B Ltd. have the following ledger balances as on 31st March, 20X1:*

| | ***A Ltd. (₹ in lakhs)*** | ***B Ltd. (₹ in lakhs)*** |
|---|---|---|
| *Land and Building* | *550* | *400* |
| *Plant and Machinery* | *350* | *250* |
| *Investments (Non-current)* | *150* | *50* |
| *Inventory* | *350* | *250* |
| *Trade Receivables* | *300* | *350* |
| *Cash and Bank* | *300* | *200* |

| | **A Ltd. (₹ in lakhs)** | **B Ltd. (₹ in lakhs)** |
|---|---|---|
| *Share Capital:* | | |
| *Equity Shares of ₹ 100 each* | *800* | *750* |
| *12% Preference shares of ₹ 100 each* | *300* | *200* |
| *Reserves and Surplus:* | | |
| *Revaluation Reserve* | *150* | *100* |
| *General Reserve* | *170* | *150* |
| *Investment Allowance Reserve* | *50* | *50* |
| *Profit and Loss Account* | *50* | *30* |
| *Secured Loans:* | | |
| *10% Debentures (₹ 100 each)* | *60* | *30* |
| *Trade Payables* | *420* | *190* |

*Additional Information:*

*(1) 10% Debenture holders of A Ltd. and B Ltd. are discharged by C Ltd. issuing such number of its 15% Debentures of ₹ 100 each so as to maintain the same amount of interest.*

*(2) Preference shareholders of the two companies are issued equivalent number of 15% preference shares of C Ltd. at a price of ₹ 150 per share (face value of ₹ 100).*

*(3) C Ltd. will issue 5 equity shares for each equity share of A Ltd. and 4 equity shares for each equity share of B Ltd. The shares are to be issued @ ₹ 30 each, having a face value of ₹ 10 per share.*

*(4) Investment allowance reserve is to be maintained for 4 more years.*

*Prepare the Balance Sheet of C Ltd. as on 1st April, 20X1 after the amalgamation has been carried out on the basis of Amalgamation in the nature of purchase.*

(*Source: Illustration 2, Study Material*)

**Answer**

**Balance Sheet of C Ltd. as at 1st April, 20X1**

| **Particulars** | **Note No.** | **(₹ in lakhs)** |
|---|---|---|
| I. Equity and Liabilities | | |
| (1) Shareholder's Funds | | |
| (a) Share Capital | 1 | 1,200 |
| (b) Reserves and Surplus | 2 | 1,650 |
| (2) Non-Current Liabilities Long-term borrowings | 3 | 60 |
| (3) Current Liabilities Trade payables | 8 | 610 |
| Total | | 3,520 |
| II. Assets | | |
| (1) Non-current assets | | |
| (a) Property, Plant and Equipment | 4 | 1,550 |
| (b) Intangible assets | 5 | 20 |
| (c) Non-current investments | 6 | 200 |
| (2) Current assets | | |
| (a) Inventory (350 + 250) | | 600 |
| (b) Trade receivables | 7 | 650 |
| (c) Cash and bank balances (300 + 200) | | 500 |
| Total | | 3,520 |

**Notes to Accounts**

| | | **(₹ in lakhs)** | **(₹ in lakhs)** |
|---|---|---|---|
| 1. | Share Capital | | |
| | Equity share capital (W.N.1) | | |
| | 70,00,000[1] Equity shares of ₹ 10 each | 700 | |
| | 5,00,000[2] Preference shares of ₹ 100 each | 500 | |
| | (all the above shares are allotted as fully paid-up pursuant to contracts without payment being received in cash) | | 1,200 |
| 2. | Reserves and surplus | | |
| | Securities Premium Account (W.N.3) (950 + 700) | 1,650 | |
| | Investment Allowance Reserve (50 + 50) | 100 | |
| | Amalgamation Adjustment Reserve (50 + 50) | *(100)* | *1,650* |
| 3. | Long-term borrowings | | |
| | 15% Debentures | | 60 |
| 4. | Property, Plant and Equipment | | |
| | Land and Building (550 + 400) | 950 | |
| | Plant and Machinery (350 + 250) | 600 | 1,550 |
| 5. | Intangible assets | | |
| | Goodwill [W.N. 2] (110 – 90) | | 20 |
| 6. | Non-current Investments | | |
| | Investments (150 + 50) | | 200 |
| 7. | Trade receivables (300 + 350) | | 650 |
| 8. | Trade payables (420 + 190) | | 610 |

**Working Notes**:

| | | *(₹ in lakhs)* | |
|---|---|---|---|
| | *(a)* Preference shareholders: | *A Ltd.* | *B Ltd.* |
| (1) | Computation of Purchase consideration | | |
| | $\left(\frac{3,00,00,000}{100} \text{ i.e. } 3,00,000 \text{ shares}\right) \times \text{Rs.}150 \text{ each}$ | 450 | |
| | $\left(\frac{2,00,00,000}{100} \text{ i.e. } 2,00,000 \text{ shares}\right) \times \text{Rs.}150 \text{ each}$ | | 300 |
| | (b) Equity shareholders: | | |
| | $\left(\frac{8,00,00,000 \times 5}{100} \text{ i.e. } 40,00,000 \text{ shares}\right) \times \text{Rs.}30 \text{ each}$ | 1,200 | |
| | $\left(\frac{7,50,00,000 \times 5}{100} \text{ i.e. } 30,00,000 \text{ shares}\right) \times \text{Rs.}30 \text{ each}$ | | 900 |
| | Amount of Purchase Consideration | 1,650 | 1,200 |

**1** 40,00,000 + 30,00,000
**2** 3,00,000 + 2,00,000

| | | | (₹ *in lakhs)* | |
|---|---|---|---|---|
| | *(a)* Preference shareholders: | | *A Ltd.* | *B Ltd.* |
| (2) | Net Assets Taken Over | | | |
| | Assets taken over: | | | |
| | Land and Building | | 550 | 400 |
| | Plant and Machinery | | 350 | 250 |
| | Investments | | 150 | 50 |
| | Inventory | | 350 | 250 |
| | Trade receivables | | 300 | 350 |
| | Cash and bank | | 300 | 200 |
| | | | 2,000 | 1,500 |
| | *Less:* Liabilities taken over: | | | |
| | Debentures | 40 | | 20 |
| | Trade payables | 420 | | 190 |
| | | | 460 | 210 |
| | Net assets taken over | | 1,540 | 1,290 |
| | Purchase consideration | | 1,650 | 1,200 |
| | Goodwill | | 110 | |
| | Capital reserve | | | 90 |
| (3) | Computation of securities premium | | | |
| | On preference share capital | | | |
| | A Ltd.- 3,00,000 x 50 | | 150 | |
| | B Ltd.- 2,00,000 x 50 | | | 100 |
| | On equity share capital | | | |
| | A Ltd.- 40,00,000 x 20 | | 800 | |
| | B Ltd.- 30,00,000 x 20 | | | 600 |
| | Total | | 950 | 700 |

## Question 3

*Briefly describe the disclosure requirements for amalgamation including additional disclosure, if any, for different methods of amalgamation as per AS 14 (Revised).*

(*Source: Theory Question 6, Study Material*)

**Answer**

The disclosure requirements for amalgamations have been prescribed in paragraphs 43 to 46 of AS 14 (Revised) on Accounting for Amalgamation. Refer Para 2.5 for details.

## Question 4

*List the conditions to be fulfilled as per AS 14 (Revised) for an amalgamation to be in the nature of merger, in the case of companies.*

(*Source: Theory Question 7, Study Material*)

**Answer**

According to AS 14 "Accounting for Amalgamations", Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

## Question 5

*Briefly explain the methods of accounting for amalgamation as per Accounting Standard-14.*

(*Source: Theory Question 8, Study Material*)

**Answer**

As per AS 14 on 'Accounting for Amalgamations', there are two main methods of accounting for amalgamations:

**The Pooling of Interest Method**

Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (after making the necessary adjustments).

If at the time of amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

**The Purchase Method**

Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

## Question 6

X Co. Ltd. having share capital of ₹ 50 lakhs divided into equity shares of ₹ 10 each was taken over by Y Co. Ltd. Y Co. Ltd. issued 11 equity shares of ₹ 10 each for every 10 shares of X Co. Ltd.

Explain how the difference will be adjusted in the books of Y Co. Ltd. for the shares issued under the 'Pooling of interests method' of amalgamation as per AS 14.

(*Source: Practical Question 9, Study Material*)

**Answer**

| **Particulars** | ₹ |
|---|---|
| Purchase consideration = 5,00,000 x 11/10 = 55,000 | 55,00,000 |
| shares of ₹ 10 each | 50,00,000 |
| Less: Share capital of X Co. Ltd. | |
| Difference Adjusted through General Reserve | 5,00,000 |

## Question 7

On 1st April, 2018, Tina Ltd. take over the business of Rina Ltd. and discharged purchase consideration as follows:

(i) Issued 50,000 fully paid Equity shares of ₹ 10 each at a premium of ₹ 5 per share to the equity shareholders of Rina Ltd.

(ii) Cash payment of ₹ 50,000 was made to equity shareholders of Rina Ltd.

(iii) Issued 2,000 fully paid 12% Preference shares of ₹ 100 each at par to discharge the preference shareholders of Rina Ltd.

(iv) Debentures of Rina Ltd. 20,000) will he converted into equal number and amount of 10% debentures of Tina Ltd.

Calculate the amount of Purchase consideration as per AS-14 and pass Journal Entry relating to discharge of purchase consideration in the books of Tina Ltd.

(*Source: Practical Question 10, Study Material*)

**Answer**

A per AS 14, consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

**Computation of Purchase Consideration**

| **Particulars** | ₹ |
|---|---|
| Equity Shares (50,000x 15) | 7,50,000 |
| Cash payment | 50,000 |
| 12% Preference Share Capital | 2,00,000 |
| Purchase Consideration | 10,00,000 |

**Note:** Payment to debenture holders are not covered by the term 'consideration'.

**Journal entry**

| **Particulars** | ₹ | ₹ |
|---|---|---|
| Liquidation of Rina Ltd. A/c | 10,00,000 | |
| To Equity share capital A/c | | 5,00,000 |
| To 12% Preference share capital A/c To Securities premium A/c | | 2,00,000<br>2,50,000 |
| To Bank/Cash A/c | | 50,000 |
| (Being payment of cash and issue of shares for discharge of purchase consideration) | | |

# QUESTION BANK

## Question 8

Som Ltd. agreed to takeover Dove Ltd. on 1st April, 2020. The terms and conditions of takeover were as follows:

(i) Som Ltd. issued 56,000 equity shares of ₹100 each at a premium of ₹10 per share to the equity shareholders of Dove Ltd.

(ii) Cash payment of ₹ 1,00,000 was made to equity shareholders of Dove Ltd.

(iii) 20,000 fully paid preference shares of ₹ 70 each issued at par to discharge the preference shareholders of Dove Ltd.

You are required to calculate the amount of purchase consideration as per the provisions of AS 14

(*RTP, November, 2020*)

**Answer**

As per AS 14, 'Accounting for Amalgamations' consideration for the amalgamation means the aggregate of shares and other securities issued and payment made in form of cash or other assets by the transferee company to the shareholders of the transferor company.

**(i) Computation of Purchase Consideration:**

| | | ₹ |
|---|---|---|
| (a) | Preference Shares: | |
| | 20,000 Preference shares in Som Ltd. @ ₹ 70 per share | 14,00,000 |
| (b) | Cash | 1,00,000 |
| (c) | Equity shares: 56,000 equity shares in Som Ltd. @ ₹ 110 per share | 61,60,000 |
| | | 76,60,000 |

## Question 9

Astha Ltd. is absorbed by Nistha Ltd.; the consideration being the takeover of liabilities, the payment of cost of absorption not exceeding ₹ 10,000 (actual cost ₹ 9,000); the payment of the 9% debentures of ₹ 50,000 at a premium of 20% through 8% debentures issued at a premium of 25% of face value and the payment of ₹15 per share in cash and allotment of three 11% preference shares of ₹ 10 each and four equity shares of ₹10 each at a premium of 20% fully paid for every five shares in Astha Ltd.

The number of shares of the vendor company are 1,50,000 of ₹ 10 each fully paid. Calculate purchase consideration as per AS 14.

(*RTP, May, 2021*)

**Answer**

As per AS 14 'Accounting for Amalgamations', the term 'consideration' has been defined as the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

The payment made by transferee company to discharge the Debenture holders and outside liabilities and cost of winding up of transferor company shall not be considered as part of purchase consideration.

**Computation of Purchase Consideration**

| | ₹ |
|---|---|
| Cash payment ₹15 x 1,50,000 | 22,50,000 |
| 11% Preference Shares of ₹ 10 each [(1,50,000 x 3/5) x ₹ 10] | 9,00,000 |
| Equity shares of ₹ 10 each @ 20% premium [(1,50,000 x 4/5) x ₹ 12] | 14,40,000 |
| Total Purchase consideration | 45,90,000 |

## Question 10

Naresh Ltd. had the following transactions during the financial year 2019 -2020:

(i) Naresh Ltd. acquired running business of Sunil Ltd. for ₹ 10,80,000 on 15th May, 2019. The fair value of Sunil Ltd.'s net assets was ₹ 5,16,000. Naresh Ltd. is of the view that due to popularity of Sunil Ltd.'s product in the market, its goodwill exists.

(ii) Naresh Ltd. had taken a franchise on July 2019 to operate a restaurant from Sankalp Ltd. for ₹1,80,000 and at an annual fee of 10% of net revenues (after deducting expenditure). The franchise expires after 6 years. Net revenues were ₹ 60,000 during the financial year 2019-2020.

(iii) On 20th August, 2019, Naresh Ltd, incurred costs of ₹ 2,40,000 to register the patent for its product. Naresh Ltd. expects the patent's economic life to be 8 years.

Naresh Ltd. follows an accounting policy to amortize all intangibles on straight line basis over the maximum period permitted by accounting standards taking a full year amortization in the year of acquisition. Goodwill on acquisition of business to be amortized over 5 years (SLM) as per AS 14.

Prepare a schedule showing the intangible assets section in Naresh Ltd. Balance Sheet at 31st March, 2020.

(*RTP, May, 2021*)

**Answer**

**Naresh Ltd.**

**Balance Sheet (Extract relating to intangible asset) as on 31st March 2020**

| | ***Note No.*** | ***₹*** |
|---|---|---|
| Assets<br>(1) Non-current assets<br>Intangible assets | 1 | 8,11,200 |

**Notes to Accounts (Extract)**

| | | ₹ | ₹ |
|---|---|---|---|
| 1. | Intangible assets | | |
| | Goodwill (Refer to note 1) | 4,51,200 | |
| | Franchise (Refer to Note 2) | 1,50,000 | |
| | Patents (Refer to Note 3) | 2,10,000 | 8,11,200 |

**Working Notes:**

| | | ₹ |
|---|---|---|
| (1) | Goodwill on acquisition of business | |
| | Cash paid for acquiring the business (purchase consideration) | 10,80,000 |
| | *Less:* Fair value of net assets acquired | (5,16,000) |
| | Goodwill | 5,64,000 |
| | *Less:* Amortisation as per AS 14 i.e. over 5 years (as per SLM) | (1,12,800) |
| | Balance to be shown in the balance sheet | 4,51,200 |
| (2) | Franchise | 1,80,000 |
| | *Less:* Amortisation (over 6 years) | (30,000) |
| | Balance to be shown in the balance sheet | 1,50,000 |
| (3) | Patent | 2,40,000 |
| | *Less:* Amortisation (over 8 years as per SLM) | (30,000) |
| | Balance to be shown in the balance sheet | 2,10,000 |

## Question 11

List the conditions to be fulfilled as per AS-14 (Revised) for an amalgamation to be in the nature of merger.

(*Suggested, January, 2021) (5 marks)*

**Answer**

Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

## Question 12

Star Limited agreed to take over Moon Limited on 1st April, 2022. The terms and conditions of takeover were as follows:

(i) Star Limited issued 70,000 Equity shares of ₹ 100 each at a premium of ₹ 10 per share to the equity shareholders of Moon Limited.

(ii) Cash payment of ₹ 1,25,000 was made to the equity shareholders of Moon Limited.

(iii) 25,000 fully paid Preference shares of ₹ 70 each issued at par to discharge the preference shareholders of Moon Limited.

You are required:

(i) to give the meaning of "consideration for the amalgamation' as per AS-14, and

(ii) Calculate the amount of purchase consideration.

(*Suggested November, 2022*) (*4 Marks*)

**Answer**

***Consideration*** for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

| ***Computation of Purchase consideration*** | **(₹)** | ***Form*** |
|---|---|---|
| For Preference Shareholders of Moon Ltd. (25,000 × ₹ 70) | 17,50,000 | 25,000 Preference |
| For equity shareholders of Moon Ltd. (70,000 × ₹ 110) | 77,00,000 | 70,000 Equity shares of Star Ltd. |
| | 1,25,000 | Cash |
| Total Purchase consideration | 95,75,000 | |

CHAPTER

# 23

# Accounting Standard 21 Consolidated Financial Statements

**Question 1**

From the following data, determine in each case:

*(1)* Minority interest at the date of acquisition and at the date of consolidation.

*(2)* Goodwill or Capital Reserve.

| |
|---|
| **Note:** In case of issue of bonus shares by the subsidiary company, the holding company, like other holders, record no entry; only the number of shares held is increased. |

*(3)* Amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own Profit & Loss Account to be ₹2,00,000 in each case:

| | ***Subsidiary Company*** | ***% shares owned*** | ***Cost*** | ***Date of acquisition*** | | ***Consolidation Date*** | |
|---|---|---|---|---|---|---|---|
| | | | | ***1.1.20X1*** | | ***31.12.20X1*** | |
| ***Case*** | | | ***₹*** | ***Share Capital ₹*** | ***Profit & Loss Account ₹*** | ***Share Capital ₹*** | ***Profit & Loss Account ₹*** |
| *Case 1* | *A* | *90%* | *1,40,000* | *1,00,000* | *50,000* | *1,00,000* | *70,000* |
| *Case 2* | *B* | *85%* | *1,04,000* | *1,00,000* | *30,000* | *1,00,000* | *20,000* |
| *Case 3* | *C* | *80%* | *56,000* | *50,000* | *20,000* | *50,000* | *20,000* |
| *Case 4* | *D* | *100%* | *1,00,000* | *50,000* | *40,000* | *50,000* | *55,000* |

(*Source: Illustration 1, Study Material*)

**Answer**

(1) *Minority Interest = Equity attributable to minorities*

*Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case it should be equal to Share Capital + Profit & Loss A/c*

| | **Minority % Shares Owned [E]** | **Minority interest as at the date of acquisition [E] x [A + B] ₹** | **Minority interest as at the date of consolidation [E] X [C + D] ₹** |
|---|---|---|---|
| Case 1 [100-90] | 10 % | 15,000 | 17,000 |
| Case 2 [100-85] | 15 % | 19,500 | 18,000 |
| Case 3 [100-80] | 20 % | 14,000 | 14,000 |
| Case 4 [100-100] | NIL | Nil | Nil |

A = *Share capital on 1.1.20X1*

*B = Profit & loss account balance on 1.1.20X1*

*C = Share capital on 31.12.20X1*

*D = Profit & loss account balance on 31.12.20X1*

(2) *Calculation of Goodwill or Capital Reserve*

| | Shareholding % [F] | Cost [G] | Total Equity [A] + [B] = [C] | Parent's Portion of equity [F] x [C] = H | Goodwill ₹ [G] - [H] | Capital Reserve ₹ [H] - [G] |
|---|---|---|---|---|---|---|
| Case 1 | 90 % | 1,40,000 | 1,50,000 | 1,35,000 | 5,000 | — |
| Case 2 | 85 % | 1,04,000 | 1,30,000 | 1,10,500 | — | 6,500 |
| Case 3 | 80 % | 56,000 | 70,000 | 56,000 | Nil | Nil |
| Case 4 | 100 % | 1,00,000 | 90,000 | 90,000 | 10,000 | — |

(3) *The balance in the Profit & Loss Account on the date of acquisition (1.1.20X1) is Capital profit, as such the balance of Consolidated Profit & Loss Account shall be equal to Holding Co.'s profit.*

*On 31.12.20X1 in each case the following amount shall be added or deducted from the balance of holding Co.'s Profit & Loss account.*

| | % Share holding [K] | P & L as on 1.1.20X1 [L] | P & L as on consolidation date [M] | P & L post acquisition [N] = [M]-[L] | Amount to be added / (deducted) from holding's P & L [O] = [K] x [N] |
|---|---|---|---|---|---|
| 1 | 90 % | 50,000 | 70,000 | 20,000 | 18,000 |
| 2 | 85 % | 30,000 | 20,000 | (10,000) | (8,500) |
| 3 | 80 % | 20,000 | 20,000 | NIL | NIL |
| 4 | 100 % | 40,000 | 55,000 | 15,000 | 15,000 |

## Question 2

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 20X1 for ₹ 1,40,000. The issued capital of ABC Ltd., on 1st January, 20X1 was ₹1,00,000 and the balance in the Profit & Loss Account was ₹60,000.

During the year ended 31st December, 20X1, ABC Ltd. earned a profit of ₹20,000 and at year end, declared and paid a dividend of ₹ 15,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd.

What is the amount of minority interest as on 1st January, 20X1 and 31st December, 20X1? Also please check whether there should be any goodwill/ capital reserve at the date of acquisition.

(*Source: Illustration 2, Study Material*)

**Answer**

*Total dividend paid is ₹ 15,000 (assumed to be out of post-acquisition profits), hence dividend received by XYZ will be credited to P & L.*

*XYZ Ltd.'s share of dividend = ₹ 15,000 X 80% = ₹ 12,000*

***In the books of XYZ Ltd.***

| | ₹ | ₹ |
|---|---|---|
| Bank A/c Dr. | 12,000 | 12,000 |
| To Profit & Loss A/c | | |
| (Dividend received from ABC Ltd credited to P&L A/c being out of post-acquisition profits - as explained above) | | |
| **Goodwill on consolidation (at the date of acquisition):** | ₹ | ₹ |
| Cost of shares | | 1,40,000 |
| *Less:* Face value of capital i.e. 80% of capital | 80,000 | |
| *Add:* Share of capital profits [60,000X 80 %] | 48,000 | (1,28,000) |
| Goodwill | | 12,000 |

| | ₹ | ₹ |
|---|---|---|
| **Minority interest on**:<br>- **1st January, 20X1:**<br>20% of ₹ 1,60,000 [1,00,000 + 60,000]<br>- **31st December, 20X1:**<br>20% of ₹ 1,65,000 [1,00,000 + 60,000 + 20,000 - 15,000] | | 32,000<br>33,000 |

## Question 3

Exe Ltd. acquires 70% of equity shares of Zed Ltd. as on 31st March, 20X1 at a cost of ₹70 lakhs. The following information is available from the balance sheet of Zed Ltd. as on 31st March, 20X1:

| | ***₹ in lakhs*** |
|---|---|
| *Property, plant and equipment* | *120* |
| *Investments* | *55* |
| *Current Assets* | *70* |
| *Loans & Advances* | *15* |
| *15% Debentures* | *90* |
| *Current Liabilities* | *50* |

*The following revaluations have been agreed upon (not included in the above figures):*

| | |
|---|---|
| Property, plant and equipment | Up by 20% |
| Investments | Down by 10% |

Zed Ltd. declared and paid dividend @ 20% on its equity shares as on 31st March, 20X1 (Face value - ₹10 per share). Exe Ltd. purchased the shares of Zed Ltd. @ ₹20 per share.

Calculate the amount of goodwill/capital reserve on acquisition of shares of Zed Ltd.

(*Source: Illustration 3, Study Material*)

**Answer**

*Revalued net assets of Zed Ltd. as on 31st March, 20X1*

| | **₹ in lakhs** | **₹ in lakhs** |
|---|---|---|
| Property, plant and equipment [120 X 120%] | | 144.0 |
| Investments [55 X 90%] | | 49.5 |
| Current Assets | | 70.0 |
| Loans and Advances | | 15.0 |
| Total Assets after revaluation | | 278.5 |
| *Less:* 15% Debentures | 90.0 | |
| Current Liabilities | 50.0 | (140.0) |
| Equity / Net Worth | | 138.5 |
| Exe Ltd.'s share of net assets (70% of 138.5) | | 96.95 |
| Exe Ltd.'s cost of acquisition of shares of Zed Ltd. | | |
| (₹ 70 lakhs - ₹ 7 lakhs*) | | 63.00 |
| Capital reserve | | 33.95 |

| | |
|---|---|
| * Total Cost of 70 % Equity of Zed Ltd | ₹ 70 lakhs |
| Purchase Price of each share | ₹ 20 |
| Number of shares purchased [70 lakhs /₹ 20] | 3.5 lakhs |
| Dividend @ 20 % i.e. ₹ 2 per share | ₹ 7 lakhs |

Since dividend received is for pre-acquisition period, it has been reduced from the cost of investment in the subsidiary company**.**

## Question 4

*A Ltd. acquired 70% of equity shares of B Ltd. on 1.4.20X1 at cost of ₹ 10,00,000 when B Ltd. had an equity share capital of ₹ 10,00,000 and reserves and surplus of ₹80,000. In the four consecutive years, B Ltd. fared badly and suffered losses of ₹2,50,000, ₹4,00,000, ₹5,00,000 and ₹ 1,20,000 respectively. Thereafter in 20X5- X6, B Ltd. experienced turnaround and registered an annual profit of ₹50,000. In the next two years i.e. 20X6-X7 and 20X7-X8, B Ltd. recorded annual profits of ₹ 1,00,000 and ₹ 1,50,000 respectively. Show the minority interests and cost of control at the end of each year for the purpose of consolidation.*

(*Source: Illustration 4, Study Material*)

**Answer**

The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. In such cases, AS 21 prescribes that the excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

Where the minority interest has a binding obligation (say by way of a shareholders₹ agreement), then the share of losses will be attributed to the minority interest even if it exceeds the minority interest in the equity (i.e., debit balance in minority interest). Since information on the existence of a binding obligation is not given in the question, we solve as if such obligation does not exist, and hence the minority interests will be computed as follows:

| ***Year*** | ***Profit/(Loss)*** | ***Minority Interest (30%)*** | ***Additional Consolidated P & L (Dr.) Cr. (for the year ended balance)*** | ***Minority's Share of losses borne by A Ltd.*** | | ***Cost of Control*** |
|---|---|---|---|---|---|---|
| | | | | ***₹*** | ***Balance*** | |
| At the time of acquisition in 20X1 | | 3,24,000<br>-<br>(W.N.) | - | | | |
| 20X1-X2 | (2,50,000) | (75,000) | (1,75,000) | | | 2,44,000<br>(W.N.) |
| Balance | | 2,49,000 | | | | |
| 20X2-X3 | (4,00,000) | (1,20,000) | (2,80,000) | | | 2,44,000 |
| Balance | | 1,29,000 | | | | |
| 20X3-X4 | (5,00,000) | (1,50,000) | (3,50,000) | | | 2,44,000 |
| | | (21,000) | | | | |
| | Loss of minority borne by Holding Co. | 21,000 | (21,000) | 21,000 | 21,000 | |
| Balance | | Nil | (3,71,000) | | | |
| 20X4-X5 | (1,20,000) | (36,000) | (84,000) | | | 2,44,000 |
| | Loss of minority borne by Holding Co. | 36,000 | (36,000) | 36,000 | 57,000 | |
| Balance | | Nil | (1,20,000) | | | |

| Year | Profit/(Loss) | Minority Interest (30%) | Additional Consolidated P & L (Dr.) Cr. (for the year ended balance) | Minority's Share of losses borne by A Ltd. | | Cost of Control |
|---|---|---|---|---|---|---|
| | | | | ₹ | Balance | |
| 20X5-X6 | 50,000 | 15,000 | 35,000 | | | 2,44,000 |
| | Profit share of minority adjusted against losses of minority absorbed by Holding Co. | (15,000) | 15,000 | (15,000) | 42,000 | |
| Balance | | Nil | 50,000 | | | |
| 20X6-X7 | 1,00,000 | 30,000 | 70,000 | (30,000) | 12,000 | 2,44,000 |
| | Profit share of minority adjusted against losses of minority absorbed by Holding Co. | (30,000) | 30,000 | | | |
| Balance | | Nil | 100,000 | | | |
| 20X7-X8 | 1,50,000 | 45,000 | 1,05,000 | (12,000) | Nil | 2,44,000 |
| | | (12,000) | 12,000 | | | |
| Balance | | 33,000 | 1,17,000 | | | |

**Working Note:**

**Calculation of Minority interest and Cost of control on 1.4.20X1**

| | | Share of Holding Co. | Minority Interest |
|---|---|---|---|
| | 100% | 70% | 30% |
| | (₹) | (₹) | (₹) |
| Share Capital | 10,00,000 | 7,00,000 | 3,00,000 |
| Reserve | 80,000 | 56,000 | 24,000 |
| | | 7,56,000 | 3,24,000 |
| *Less:* Cost of investment | | (10,00,000) | |
| Goodwill | | 2,44,000 | |

## Question 5

*Variety Ltd. holds 46% of the paid-up share capital of VR Ltd. The shares were acquired at a market price of ₹ 17 per share. The balance of shares of VR Ltd. are held by a foreign collaborating company. A memorandum of understanding has been entered into with the foreign company providing for the following:*

(a) *The shares held by the foreign company will be sold to Variety Ltd. The price per share will be calculated by capitalising the yield at 15%. Yield, for this purpose, would mean 40% of the average of pre-tax profits for the last 3 years, which were ₹30 lakhs, ₹40 lakhs and ₹ 65 lakhs.*

(b) *The actual cost of the shares to the foreign company was ₹5,40,000 only. The profit that would accrue to them would be taxable at an average rate of 30%. The tax payable will be deducted from the proceeds and Variety Ltd. will pay it to the Government.*

(c) *Out of the net consideration, 50% would be remitted to the foreign company immediately and the balance will be an unsecured loan repayable after two years.*

*The above agreement was approved by all concerned for being given effect to on 1.4.20X1. The total assets of VR Ltd. as on 31st March, 20X1 was ₹ 1,00,00,000. It was decided to write down Property, Plant and Equipment by ₹ 1,75,000. Current liabilities of VR Ltd. as on the same date were ₹ 20,00,000. The paid-up share capital of VR Ltd. was ₹20,00,000 divided into 2,00,000 equity shares of ₹ 10 each.*

*Find out goodwill/capital reserve to Variety Ltd. on acquiring wholly the shares of VR Ltd.*

(*Source: Illustration 5, Study Material*)

**Answer**

**1. Computation of Purchase Consideration**

(a) Yield of VR Ltd.: $\left[\frac{40}{30} \times \frac{30+40+50}{3}\right]$ ₹ 18 lakhs

(b) <u>Price per share of VR Ltd.:</u>

Capitalized Yield: $\left[\frac{18\,\text{lakhs}}{0.15}\right]$ ₹ 120 lakhs

No. of shares 2 lakhs

Therefore, price per share ₹ 60

(c) Purchase Consideration for 54% shares in VR Ltd.

2 lakh shares x 54% x ₹ 60 per shares ₹ 64.80 lakhs

(d) Discharge of Purchase Consideration:

Tax at source (₹ 64.80 lakhs - ₹ 5.40 lakhs) x $\frac{30}{100}$ ₹ 17.82 lakhs

50% of purchase consideration (net of tax) in cash [₹ (64.80 - 17.82) x 50%] ₹ 23.49 lakhs

Balance - Unsecured Loan ₹ 23.49 lakhs

**2. Goodwill / Capital Reserve to Variety Ltd.**

| | ₹ in lakhs | |
|---|---|---|
| Total Assets | 100.00 | 78.25 |
| Less: Reduction in Value of Property, Plant and | (1.75) | |
| Equipment | 98.25 | |
| Less: Current Liabilities | (20.00) | |
| Net Assets of VR Ltd. on Date of Acquisition | | |
| Purchase Consideration: 54% purchased from Foreign Co. | 64.80 | (80.44) |
| Investment: 46% existing stake | 15.64 | **2.19** |
| **Goodwill on Date of Acquisition** | | |

## Question 6

*A Ltd. acquired 60% shares of B Ltd. @ ₹20 per share. Following is the extract of Balance Sheet of B Ltd.:*

| | ₹ |
|---|---|
| *10,00,000 Equity Shares of ₹ 10 each* | *1,00,00,000* |
| *10% Debentures* | *10,00,000* |
| *Trade Payables* | *55,00,000* |
| *Property, Plant and Equipment* | *70,00,000* |
| *Investments* | *45,00,000* |
| *Current Assets* | *68,00,000* |
| *Loans and Advances* | *22,00,000* |

*On the same day B Ltd. declared dividend at 20% and as agreed between both the companies Property, Plant and Equipment were to be depreciated @ 10% and investment to be taken at market value of ₹60,00,000. Calculate the Goodwill or Capital Reserve to be recorded in Consolidated Financial Statements.*

(*Source: Illustration 6, Study Material*)

**Answer**

Since dividend is declared by B Ltd. on the date of acquisition itself, it would be out of the divisible profits of B Ltd. existing on the date of acquisition i.e., preacquisition profits from the perspective of A Ltd. Accordingly, as per AS 13, such pre-acquisition dividend would be reduced from the cost of investment, as seen below in the determination of Goodwill on the date of acquisition.

| | ₹ | ₹ |
|---|---:|---:|
| Assets | | |
| Property, Plant and Equipment | 70,00,000 | |
| Less: Value written off (₹ 70 lakhs x 10%) | (7,00,000) | |
| | 63,00,000 | |
| Investments at Market Value | 60,00,000 | |
| Current Assets | 68,00,000 | |
| Loans and Advances | 22,00,000 | 2,13,00,000 |
| Less: Liabilities | | |
| Trade Payables | 55,00,000 | |
| 10% Debentures | 10,00,000 | (65,00,000) |
| Net Assets of B Ltd. | | 1,48,00,000 |
| Share of A Ltd. in Net Assets of B Ltd.: 60% | | 88,80,000 |
| Less: Cost of Investment in B Ltd. (60% stake): | | |
| 10,00,000 Equity Shares x 60% x ₹ 20 per share | 1,20,00,000 | |
| Less: Pre-acquisition dividend: 6,00,000 shares x ₹ 2 | (12,00,000) | (1,08,00,000) |
| **Goodwill on Date of Acquisition** | | **19,20,000** |

## Question 7

*H Ltd. acquired 3,000 shares in S Ltd., at a cost of ₹4,80,000 on 31.7.20X1. The capital of S Ltd. consisted of 5,000 shares of ₹ 100 each fully paid. The Profit & Loss Account of this company for 20X1 showed an opening balance of ₹ 1,25,000 and profit for the year was ₹3,00,000. At the end of the year, it declared a dividend of 40%. Record the entry in the books of H Ltd., in respect of the dividend. Assume the profit is accruing evenly and calendar year as financial year.*

(*Source: Illustration 7, Study Material*)

**Answer**

The profits of S Ltd., have to be divided between capital and revenue profits from the point of view of the holding company:

| | ***Capital Profit (Preacquisition)*** ₹ | | ***Revenue Profit (Postacquisition)*** ₹ |
|---|---:|---:|---:|
| Balance on 1.1.20X1 | 1,25,000 | — | |
| Profit for 20X1 (3,00,000 x 7/12) | 1,75,000 | (3,00,000x5/12) | 1,25,000 |
| Total | 3,00,000 | | 1,25,000 |
| Proportionate share of H Ltd. (3/5) | 1,80,000 | | 75,000 |

Total dividend declared = ₹ 5,00,000 X 40 % = ₹ 2,00,000

H Ltd.'s share in the dividend = ₹ 2,00,000 X 3/5 = ₹ 1,20,000

There can be two situations as regards the treatment of dividend of ₹ 1,20,000:

(1) The profit for 20X1 has been utilised to pay the dividend.

The share of H Ltd in profit for the first seven months of S Ltd = ₹ 1,05,000 (i.e. ₹ 1,75,000 x 3/5)

*Profit for the remaining five months = ₹ 75,000 (i.e.₹ 1,25,000 x 3/5).*

*The dividend of ₹ 1,20,000 will be adjusted in this ratio of 1,05,000: 75,000 = ₹ 70,000 out of profits up to 31.7.20X1 and ₹ 50,000 out of profits after that date.*

*The dividend out of profits subsequent to 31.7.20X1 will be revenue income and that out of earlier profits will be capital receipt. Hence the entry will be:*

| | | ₹ | ₹ |
|---|---|---|---|
| Bank | Dr. | 1,20,000 | |
| To Investment Account | | | 70,000 |
| To Profit and Loss Account | | | 50,000 |

(2) Later profits have been utilised first and then pre- acquisition profits.

*In such a case, the whole of ₹ 75,000 (share of H Ltd. in profits of S Ltd., after 31.7.20X1) would be received and treated as revenue income; the remaining dividend, ₹45,000 (₹1,20,000 less ₹ 75,000) would be capital receipt. The entry would be:*

| | | ₹ | ₹ |
|---|---|---|---|
| Bank | Dr. | 1,20,000 | |
| To Investment Account | | | 45,000 |
| To Profit & Loss Account | | | 75,000 |

**Note:** Point (2) discussed above can arise only if there is definite information about the profits utilized. In practice, such treatment is rare.

## Question 8

*A Ltd. and B Ltd. provide the following information:*

| | | **₹ 000s** |
|---|---|---|
| | **A Ltd.** | **B Ltd.** |
| *Equity Shares* | *6,000* | *5,000* |
| *6% Preference Shares* | *NIL* | *1,000* |
| *General Reserve* | *1,200* | *800* |
| *Profit and Loss Account* | *1,020* | *1,790* |
| *Trade Payables* | *3,850* | *3,410* |
| *Dividend Payable* | *600* | *500* |
| *Goodwill* | *100* | *20* |
| *Property, Plant and Equipment* | *3,850* | *2,750* |
| *Investment* | *1,620* | *1,100* |
| *Inventory* | *1,900* | *4,150* |
| *Trade Receivables* | *4,600* | *4,080* |
| *Cash & Bank* | *600* | *400* |

*A Ltd. purchased 3/4th interest in B Ltd. at the beginning of the year at the premium of 25%. Following other information is available:*

(a) *Profit & Loss Account of B Ltd. includes f 1,000 thousands bought forward from the previous year.*

(b) *The General Reserve balance is brought forward from the previous year.*

(c) *The directors of both the companies have declared a dividend of 10% on equity share capital for the previous and current year.*

*From the above information calculate Pre- and Post-acquisition Profits, Minority Interest and Cost of Control.*

(*Source: Illustration 8, Study Material*)

**Answer**

**Calculation of Pre- and Post-Acquisition Profits:**

| | **Pre-Acquisition Profits (?)** | **Post-Acquisition Profits (?)** |
|---|---|---|
| Profit & Loss Account | 10,00,000 | 7,90,000 |
| General Reserve | 8,00,000 | NIL |
| | 18,00,000 | 7,90,000 |

| | **Pre-Acquisition Profits (?)** | **Post-Acquisition Profits (?)** |
|---|---|---|
| Less: Share of Minority Interest: (%) | (4,50,000) | (1,97,500) |
| Attributable to Parent | 13,50,000 | 5,92,500 |
| | (Cost of Control) | (Post-acquisition Profits) |

**Calculation of Minority Interest:**

| **Particulars** | **₹** |
|---|---|
| Paid-up Equity Share Capital (^ 50,00,000 x %) | 12,50,000 |
| Paid-up Preference Share Capital | 10,00,000 |
| Share in Reserves: | |
| Profit & Loss Account: ^ 17,90,000 x % | 4,47,500 |
| General Reserve: ^ 8,00,000 x % | 2,00,000 |
| **Minority Interest** | **28,97,500** |

**Calculation of Goodwill/Capital Reserve**

| | ₹ | ₹ |
|---|---|---|
| Cost of Investment in Subsidiary:<br>^50,00,000 x 75% x 125% (cost + 25% premium) | 46,87,500 | |
| Less: Pre-acquisition dividend | (3,75,000) | 43,12,500 |
| Less: Net Worth of B Ltd. on Date of Acquisition (attributable to A Ltd.): | | |
| Paid-up Capital | 37,50,000 | |
| Pre-acquisition Reserves | 13,50,000 | (51,00,000) |
| Capital Reserve | | 7,87,500 |

## Question 9

On 31s March, 20X1, P Ltd. acquired ₹1,05,000 shares of Q Ltd. for ₹ 12,00,000. The position of Q Ltd. on that date was as under:

| | ₹ |
|---|---|
| *Property, plant and equipment* | *10,50,000* |
| *Current Assets* | *6,45,000* |
| *1,50,000 equity shares of ₹ 10 each fully paid* | *15,00,000* |
| *Pre-incorporation profits* | *30,000* |
| *Profit and Loss Account* | *60,000* |
| *Trade payables* | *1,05,000* |

***P Ltd. and Q Ltd. give the following information on 31st March, 20X3:***

| | ***P Ltd.*** *₹* | ***Q Ltd.*** *₹* |
|---|---|---|
| *Equity shares of ₹ 10 each fully paid (before bonus issue)* | *45,00,000* | *15,00,000* |
| *Securities Premium* | *9,00,000* | *—* |
| *Pre-incorporation profits* | *—* | *30,000* |
| *General Reserve* | *60,00,000* | *19,05,000* |
| *Profit and Loss Account* | *15,75,000* | *4,20,000* |
| *Trade payables* | *5,55,000* | *2,10,000* |

| | ***P Ltd.*** ₹ | ***Q Ltd.*** ₹ |
|---|---:|---:|
| *Property, plant and equipment* | *79,20,000* | *23,10,000* |
| *Investment: 1,05,000 Equity shares in Q Ltd. at cost* | *12,00,000* | *—* |
| *Current Assets* | *44,10,000* | *17,55,000* |

*Directors of Q Ltd. made bonus issue on 31.3.20X3 in the ratio of one equity share of ₹ 10 each fully paid for every two equity shares held on that date. Bonus shares were issued out of post-acquisition profits by using General Reserve.*

*Calculate as on 31st March, 20X3 (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account in each of the following cases:*

*(a) Before issue of bonus shares;*

*(b) Immediately After issue of bonus shares.*

(*Source: Illustration 9, Study Material*)

**Answer**

**Shareholding pattern**

| **Particulars** | **Number of Shares** | **% of holding** |
|---|---:|---:|
| **(a) P Ltd.** | | |
| **(i) Purchased on 31.03.20X1** | **1,05,000** | |
| **(ii) Bonus Issue (1,05,000/2)** | **52,500** | |
| **Total** | **1,57,500** | **70%** |
| **(b) Minority Interest** | **67,500** | **30%** |

Calculations of (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account as on 31st March, 20X3:

**(a) Before issue of bonus shares**

| **(i)** | **Cost of control/capital reserve** | ₹ | ₹ |
|---|---|---:|---:|
| | Investment in Q Ltd. | | 12,00,000 |
| | *Less*: Face value of investments (Share Capital) | 10,50,000 | |
| | Capital profits (W.N.) | 63,000 | (11,13,000) |
| | Cost of control (i.e., Goodwill) | | 87,000 |
| **(ii)** | **Minority Interest** | | ₹ |
| | Share Capital | | 4,50,000 |
| | Capital profits (W.N.) | | 27,000 |
| | Revenue profits (W.N.) | | 6,79,500 |
| | | | 11,56,500 |
| **(iii)** | **Consolidated profit and loss account - P Ltd.** | | ₹ |
| | Balance | | 15,75,000 |
| | Add: Share in revenue profits of Q Ltd. | | 15,85,500 |
| | (W.N.) | | 31,60,500 |

**(b) Immediately after issue of bonus shares**

| **(i)** | **Cost of control/capital reserve** | ₹ | ₹ |
|---|---|---:|---:|
| | Face value of investments (₹ 10,50,000 + ₹ 5,25,000) | 15,75,000 | |
| | Capital Profits (W.N.) | 63,000 | 16,38,000 |
| | Less: Investment in Q Ltd. | | (12,00,000) |
| | Capital reserve | | 4,38,000 |

| **(ii)** | **Minority Interest** | | ₹ |
|---|---|---|---|
| | Share Capital (₹ 4,50,000 + ₹ 2,25,000) | | 6,75,000 |
| | Capital Profits (W.N.) | | 27,000 |
| | Revenue Profits (W.N.) | | 4,54,500 |
| | | | 11,56,500 |
| **(iii)** | **Consolidated Profit and Loss Account - P Ltd.** | | ₹ |
| | Balance | | 15,75,000 |
| | Add: Share in revenue profits of Q Ltd. (W.N.) | | 10,60,500 |
| | | | 26,35,500 |

**Working Note:**

**Analysis of Profits of Q Ltd.**

| | **Capital Profits (Pre-acquisition)** | **Revenue Profits (Post-acquisition)** | |
|---|---|---|---|
| | **(Before and after issue of bonus shares)** ₹ | **Before Bonus Issue** ₹ | **After Bonus Issue** ₹ |
| Pre-incorporation profits | 30,000 | | |
| Profit and loss account on | 60,000 | | |
| 31.3.20X1 | 90,000 | | |
| General reserve* | | 19,05,000 | 19,05,000 |
| *Less*: Bonus shares | | | (7,50,000) |
| | | | 11,55,000 |
| Profit for period of 1st April, 20X1 to 31st March, 20X3 | | 3,60,000 | 3,60,000 |
| (₹ 4,20,000 - ₹ 60,000) | | 22,65,000 | 15,15,000 |
| P Ltd.'s share (70%) | 63,000 | 15,85,500 | 10,60,500 |
| Minority's share (30%) | 27,000 | 6,79,500 | 4,54,500 |

*Share of P Ltd. in General reserve has been adjusted in Consolidated Profit and Loss Account.

## Question 10

*Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31 March, 20X1 from the following information:*

| | ***H Ltd.*** | ***S Ltd.*** |
|---|---|---|
| | *₹* | *₹* |
| *PPE* | *5,00,000* | *3,00,000* |
| *Investments* | | |
| *(20,000 equity shares of S Ltd.)* | *2,20,000* | |
| *Current Assets* | *1,55,000* | *1,00,000* |
| *Share capital (Fully paid equity shares of ₹ 10 each)* | *5,00,000* | *2,50,000* |
| *Profit and loss account* | *2,00,000* | *1,00,000* |
| *Trade Payables* | *1,75,000* | *50,000* |

*H Ltd. acquired the shares of S Ltd. on 31st March, 20X1.*

(*Source: Illustration 10, Study Material*)

**Answer**

*Percentage of holding:*

| | | No. of Shares | Percentage |
|---|---|---|---|
| Holding Co | : | 20,000 | (80%) |
| Minority shareholders | : | 5,000 | (20%) |
| TOTAL SHARES | : | 25,000 | |

***Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March,20X1***

| | | Note No | Amount (₹) |
|---|---|---|---|
| | **I EQUITY AND LIABILITIES** | | |
| *1* | **Shareholder's Fund** | | |
| | (a) Share Capital | 1 | 5,00,000 |
| | (b) Reserve and Surplus | 2 | 2,60,000 |
| **2** | **Minority interest** | 3 | |
| **3** | **Current Liabilities** | | 70,000 |
| | **(a)** Trade payables | 4 | 2,25,000 |
| | **Total** | | 10,55,000 |
| | **II ASSETS** | | |
| **1.** | **Non-Current Assets** | | |
| | PPE | 5 | 8,00,000 |
| **2.** | **Current Assets** | 6 | 2,55,000 |
| | **Total** | | 10,55,000 |

**Notes to Accounts**

| | | | Amounts (₹) |
|---|---|---|---|
| 1 | **Share capital** | | |
| | 50,000 Equity Shares @ ₹10 each | | 5,00,000 |
| 2 | **Reserve and Surplus** | | |
| | Capital Reserve (W.N.) | | 60,000 |
| | Profit and loss account | | 2,00,000 |
| | | | 2,60,000 |
| 3 | **Minority Interest** | | |
| | Paid up value of shares | 50,000 | |
| | *Add*: Share in Profit and loss account 20,000 | | 70,000 |
| 4 | **Trade payables** | | |
| | H Ltd. | | 1,75,000 |
| | S Ltd. | | 50,000 |
| | | | 2,25,000 |
| 5 | **PPE** | | |
| | H Ltd. | | 5,00,000 |
| | S Ltd. | | 3,00,000 |
| | | | 8,00,000 |
| 6 | **Current Assets** | | |
| | H Ltd. | | 1,55,000 |
| | S Ltd. | | 1,00,000 |
| | | | 2,55,000 |

**Working Note:**

| **Determination of Goodwill/(*Capital Reserve*)** | | **(₹)** |
|---|---|---|
| Cost of investment | | 2,20,000 |
| *Less*: Paid up value of shares (80% of 2,50,000) | 2,00,000 | |
| Share in pre-acquisition profits (80% of 1,00,000) | 80,000 | (2,80,000) |
| Capital Reserve | | (60,000) |

## Question 11

*H Ltd. and S Ltd. provide the following information as at 31st March,20X2:*

| | ***H Ltd.*** | ***S Ltd.*** |
|---|---|---|
| | *₹* | *₹* |
| *PPE* | *1,00,000* | *1,30,000* |
| *Investments (8,000 equity shares of S Ltd.)* | *1,26,000* | |
| *Current Assets* | *74,000* | *70,000* |
| *Share capital (Fully paid equity shares of ₹10 each)* | *1,50,000* | *1,00,000* |
| *Profit and loss account* | *50,000* | *40,000* |
| *Trade Payables* | *1,00,000* | *60,000* |

*Additional information:*

*H Ltd. acquired the shares of S Ltd. on 1-7-20X1 and Balance of profit and loss account of S Ltd. on 1-4-20X1 was 30,000.*

*Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31st March, 20X2.*

(*Source: Illustration 11, Study Material*)

**Answer**

Percentage of holding:

| | | **No. of Shares** | **Percentage** |
|---|---|---|---|
| Holding Co. | : | 8,000 | (80%) |
| Minority shareholders : | | 2,000 | (20%) |
| TOTAL SHARES | : | 10,000 | |

**Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd.**
**as at 31st March, 20X2**

| | | Note No | Amount (₹) |
|---|---|---|---|
| | **I EQUITY AND LIABILITYES** | | |
| **1** | Shareholder's Fund | | |
| | (a) Share Capital | 1 | 1,50,000 |
| | (b) Reserve and Surplus | 2 | 56,000 |
| **2** | Minority interest | 3 | 28,000 |
| **3** | Current Liabilities | | |
| | (a) Trade payables | 4 | 1,60,000 |
| | **Total** | | **3,94,000** |

**Notes to Accounts**

| | | | |
|---|---|---|---|
| | **II ASSETS** | | |
| **1** | Non-Current Assets: | | |
| | PPE | 5 | 2,30,000 |

| | | | | |
|---|---|---|---|---|
| | Intangible Asset | | 6 | 20,000 |
| **2** | Current Assets | | 7 | 1,44,000 |
| | **Total** | | | **3,94,000** |
| **1** | **Share capital** | | | 1,50,000 |
| | 15,000 Equity Shares @ ₹10 each | | | |
| **2** | **Reserve and Surplus** | | | |
| | Profit and loss account (₹ 50,000+ 80% of 9/12 x 10,000) | | | 56,000 |
| **3** | **Minority Interest** | | | |
| | Share capital (20% of ₹ 1,00,000) | 20,000 | | |
| | Share in Profit and loss account (₹ 40,000 X 20%) | 8,000 | | 28,000 |
| **4** | **Trade payables** | | | |
| | H Ltd. | | | 1,00,000 |
| | S Ltd. | | | 60,000 |
| | | | | 1,60,000 |
| **5** | **PPE** | | | |
| | H Ltd. | | | 1,00,000 |
| | S Ltd. | | | 1,30,000 |
| | | | | 2,30,000 |
| 6 | Intangible Asset | | | |
| | Cost of Investment | | | 1,26,000 |
| | *Less:* Paid up value of shares (80% of ₹ 1,00,000) | | | |
| | Share in pre-acquisition profits | | | (80,000) |
| | 80% of [30,000 + 3/12(40,000-30,000)] | | | (26,000) |
| | Goodwill | | | 20,000 |
| **7** | **Current Assets** | | | |
| | H Ltd. | | | 74,000 |
| | S Ltd. | | | 70,000 |
| | | | | 1,44,000 |

## Question 12

*From the Balance Sheets and information given below, prepare Consolidated Balance Sheet of Virat Ltd. and Anushka Ltd. as at 31st March. Virat Ltd. holds 80% of Equity Shares in Anushka Ltd. since its (Anushka Ltd.'s) incorporation.*

***Balance Sheet of Virat Ltd. and Anushka Ltd. as at 31st March, 20X1***

| ***Particulars*** | ***Note No.*** | ***Virat Ltd. (₹)*** | ***Anushka Ltd. (₹)*** |
|---|---|---|---|
| ***I. Equity and Liabilities*** | | | |
| ***(1) Shareholder's Funds*** | | | |
| *(a) Share Capital* | *1* | *6,00,000* | *4,00,000* |
| *(b) Reserves and Surplus* | *2* | *1,00,000* | *1,00,000* |
| ***(2) Non-current Liabilities*** | | | |
| *Long Term Borrowings* | | *2,00,000* | *1,00,000* |
| ***(3) Current Liabilities*** | | | |
| *(a) Trade Payables* | | *1,00,000* | *1,00,000* |
| *Total* | | *10,00,000* | *7,00,000* |

| ***Particulars*** | ***Note No.*** | ***Virat Ltd. (₹)*** | ***Anushka Ltd. (₹)*** |
|---|---|---|---|
| ***II. Assets*** | | | |
| ***(1) Non-current assets*** | | | |
| *(a) Property, Plant and Equipment* | | *4,00,000* | *3,00,000* |
| *(b) Non-current investments* | *3* | *3,20,000* | *-* |
| ***(2) Current Assets*** | | | |
| *(a) Inventories* | | *1,60,000* | *2,00,000* |
| *(b) Trade Receivables* | | *80,000* | *1,40,000* |
| *(c) Cash & Cash Equivalents* | | *40,000* | *60,000* |
| *Total* | | *10,00,000* | *7,00,000* |

***Notes to Accounts***

| | ***Particulars*** | *(₹)* | ***Virat Ltd. (₹)*** | ***Anushka Ltd. (₹)*** |
|---|---|---|---|---|
| ***1.*** | ***Share capital*** | | | |
| | *60,000 equity shares of ₹ 10 each fully paid up* | | *6,00,000* | *—* |
| | *40,000 equity shares of ₹ 10 each fully paid up* | | *—* | *4,00,000* |
| | *Total* | | *6,00,000* | *4,00,000* |
| ***2.*** | ***Reserves and Surplus*** | | | |
| | *General Reserve* | | *1,00,000* | *1,00,000* |
| | *Total* | | *1,00,000* | *1,00,000* |
| ***3.*** | ***Non-current investments*** | | | |
| | *Shares in Anushka Ltd* | | *3,20,000* | *—* |

(*Source: Illustration 12, Study Material*)

***Answer***

***Consolidated balance Sheet of Virat Ltd. and its Subsidiary Anushka Ltd. as at 31st March, 20X1***

| | **Particulars** | **Note** | **Amount (₹)** |
|---|---|---|---|
| **I** | **EQUITY AND LIABILITIES:** | | |
| **(1)** | **Shareholders₹ Funds:** | | |
| | (a) Share Capital | 1 | 6,00,000 |
| | (b) Reserve and Surplus | 2 | 1,80,000 |
| **(2)** | **Minority Interest** | 3 | 1,00,000 |
| **(3)** | **Non-Current Liabilities:** | | |
| | Long Term Borrowings | 4 | 3,00,000 |
| **(4)** | **Current Liabilities:** | | |
| | Trade Payables | 5 | 2,00,000 |
| | **Total** | | **13,80,000** |
| **II** | **ASSETS:** | | |
| **(1)** | **Non-Current Assets** | | |
| | Property, Plant & Equipment | 6 | 7,00,000 |
| **(2)** | **Current Assets:** | | |
| | (a) Inventories | | |
| | (b) Trade receivables | 7 | 3,60,000 |
| | (c) Cash and Cash Equivalents | 8 | 2,20,000 |
| | | 9 | 1,00,000 |
| | **Total** | | **13,80,000** |

**Notes to Accounts**

| | **Particulars** | ₹ | ₹ |
|---|---|---|---|
| **1.** | **Share capital** | | |
| | 60,000 equity shares of ₹10 each fully paid up | | 6,00,000 |
| **2.** | **Reserves and Surplus** | | |
| | General Reserve | 1,00,000 | |
| | *Add:* General reserve of Anushka Ltd (80%) | 80,000 | |
| | Total | | 1,80,000 |
| **3.** | **Minority interest** | | |
| | 20% share in Anushka Ltd (WN 3) | | 1,00,000 |
| **4** | **Long term borrowings** | | |
| | Long term borrowings of Virat | 2,00,000 | |
| | *Add:* Long term borrowings of Anushka | 1,00,000 | |
| | Total | | 3,00,000 |
| **5.** | **Trade payables** | | |
| | Trade payables of Virat | 1,00,000 | |
| | *Add:* Trade payables of Anushka | 1,00,000 | |
| | Total | | 2,00,000 |
| **6.** | **Property, Plant and Equipment (PPE)** | | |
| | PPE of Virat Ltd | 4,00,000 | |
| | *Add:* PPE of Anushka Ltd | 3,00,000 | |
| | Total | | 7,00,000 |
| **7.** | **Inventories** | | |
| | Inventories of Virat Ltd | 1,60,000 | |
| | *Add:* Inventories of Anushka Ltd | 2,00,000 | |
| | Total | | 3,60,000 |
| **8.** | **Trade receivables** | | |
| | Trade receivables of Virat Ltd | 80,000 | |
| | *Add:* Trade receivables of Anushka Ltd | 1,40,000 | |
| | Total | | 2,20,000 |
| **9** | **Cash and cash equivalents** | | |
| | Cash and cash equivalents of Virat Ltd | 40,000 | |
| | *Add:* Cash and cash equivalents of Anushka Ltd | 60,000 | |
| | Total | | 1,00,000 |

***1. Basic Information***

| **Company Status** | **Dates** | **Holding Status** |
|---|---|---|
| Holding Co. = Virat Ltd.<br>Subsidiary = Anushka Ltd. | Acquisition:<br>Anushka's Incorporation<br>Consolidation: 31st March, 20X1 | Holding Company = 80%<br>Minority Interest = 20% |

**2. Analysis of General Reserves of Anushka Ltd**

*Since Virat holds shares in Anushka since its incorporation, the entire Reserve balance of ₹1,00,000 will be Revenue.*

**3. Consolidation of Balances**

| **Holding- 80%, Minority - 20%** | **Total** | **Minority Interest** | **Holding Company** | |
|---|---|---|---|---|
| Equity Capital | 4,00,000 | 80,000 | 3,20,000 | - |
| General Reserves | 1,00,000 | 20,000 | Nil (pre-acq) | 80,000 (post-acq) |
| Total | | 1,00,000 | 3,20,000 | 80,000 |
| Cost of Investment Goodwill/capital reserve | | | (3,20,000)<br>NIL | - |
| Parent's Balance | | | | 1,00,000 |
| Amount for Consolidated Balance Sheet | | | | 1,80,000 |

## Question 13

*From the following balance sheets of H Ltd. And its subsidiary S Ltd. drawn up at 31st March, 20X1, prepare a consolidated balance sheet as at that date, having regard to the following:*

*(i) Reserves and Profit and Loss Account of S Ltd. stood at ₹25,000 and ₹ 15,000 respectively on the date of acquisition of its 80% shares by H Ltd. on 1st April, 20X0.*

*(ii) Machinery (Book-value ₹ 1,00,000) and Furniture (Book value ₹ 20,000) of S Ltd. were revalued at ₹ 1,50,000 and ₹ 15,000 respectively on 1st April, 20X0 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.]*

***Balance Sheet of H Ltd. and S Ltd. as at 31st March, 20X1***

| **Particulars** | **Note No.** | **H Ltd. (₹)** | **S Ltd. (₹)** |
|---|---|---|---|
| ***I. Equity and Liabilities*** | | | |
| ***(1) Shareholder's Funds*** | | | |
| *(a) Share Capital* | *1* | *6,00,000* | *1,00,000* |
| *(b) Reserves and Surplus* | *2* | *3,00,000* | *1,00,000* |
| ***(2) Current Liabilities*** | | | |
| *(a) Trade Payables* | | *1,50,000* | *57,000* |
| *Total* | | *10,50,000* | *2,57,000* |
| ***II. Assets*** | | | |
| ***(1) Non-current assets*** | | | |
| *(a) Property, Plant and Equipment* | *3* | *4,50,000* | *1,07,000* |
| *(b) Other non-current investments* | *4* | *6,00,000* | *1,50,000* |
| *Total* | | *10,50,000* | *2,57,000* |

**Notes to Accounts**

| | | *₹* | ***H Ltd. (₹)*** | ***S Ltd. (₹)*** |
|---|---|---|---|---|
| ***1.*** | ***Share capital*** | | | |
| | *6,000 equity shares of ₹ 100 each, fully paid up* | | *6,00,000* | *—* |
| | *1,000 equity shares of ₹ 100 each, fully paid up* | | *- -* | *1,00,000* |
| | *Total* | | *6,00,000* | *1,00,000* |
| ***2.*** | ***Reserves and Surplus*** | | | |
| | *General reserves* | | *2,00,000* | *75,000* |
| | *Profit and loss account* | | *1,00,000* | *25,000* |
| | *Total* | | *3,00,000* | *1,00,000* |

| | | ₹ | H Ltd. (₹) | S Ltd. (₹) |
|---|---|---|---|---|
| ***3.*** | ***Property, Plant and Equipment*** | | | |
| | *Machinery* | | *3,00,000* | *90,000* |
| | *Furniture* | | *1,50,000* | *17,000* |
| | *Total* | | *4,50,000* | *1,07,000* |
| ***4.*** | ***Other Non-current investments*** | | | |
| | *Non-current Investments* | | *4,40,000* | *1,50,000* |
| | *Shares in S Ltd.* | | *1,60,000* | *—* |
| | *(800 shares at ₹200 each)* | | | |
| | *Total* | | *6,00,000* | *1,50,000* |

(*Source: Illustration 13, Study Material*)

**Answer**

**Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 20X1**

| Particulars | Note No. | (₹) |
|---|---|---|
| **I. Equity and Liabilities** | | |
| **(1) Shareholder's Funds** | | |
| (a) Share Capital | 1 | 6,00,000 |
| (b) Reserves and Surplus | 2 | 3,44,600 |
| **(2) Minority Interest** | 3 | 48,150 |
| **(3) Current Liabilities** | | |
| (a) Trade Payables | | 2,07,000 |
| **Total** | | **11,99,750** |
| **II. Assets** | | |
| **(1) Non-current assets** | | |
| (a) Property, Plant and Equipment | 4 | 5,97,750 |
| (b) Intangible assets | 5 | 12,000 |
| (c) Other non-current investments | 6 | 5,90,000 |
| **Total** | | **11,99,750** |

**Notes to Accounts**

| | | | | ₹ |
|---|---|---|---|---|
| 1. | **Share capital** | | | |
| | 6,000 equity shares of ₹ 100 each, fully paid up | | | 6,00,000 |
| | Total | | | 6,00,000 |
| 2. | **Reserves and Surplus** | | | |
| | Reserves | | 2,00,000 | |
| | *Add:* 4/5th share of S Ltd.'s post acquisition reserves (W.N.3) | | 40,000 | 2,40,000 |
| | Profit and Loss Account | | 1,00,000 | |
| | *Add:* 4/5th share of S Ltd.'s post acquisition profits (W.N.4) | | 4,600 | 1,04,600 |
| | Total | | | 3,44,600 |
| 3. | **Minority interest in S Ltd.** (WN 5) | | | 48,150 |

| | | | | ₹ |
|---|---|---|---|---|
| **4.** | **Property, plant and equipment** | | | |
| | Machinery | | | |
| | H. Ltd. | | 3,00,000 | |
| | S Ltd. | 1,00,000 | | |
| | Add: Appreciation | 50,000 | | |
| | | 1,50,000 | | |
| | Less: Depreciation (1,50,000 X 10%)* | (15,000) | 1,35,000 | |
| | Furniture | | | |
| | H. Ltd. | | 1,50,000 | |
| | S Ltd. | 20,000 | | |
| | *Less*: Decrease in value | (5,000) | | |
| | | 15,000 | | |
| | *Less*: Depreciation (15,000 X 15%)* | (2,250) | 12,750 | 5,97,750 |
| **5.** | **Intangible assets** | | | |
| | Goodwill [WN 6] | | | 12,000 |
| 6. | Other non-current investments | | | |
| | H Ltd. | | 4,40,000 | |
| | S Ltd. | | 1,50,000 | |
| | Total | | | 5,90,000 |

* As an alternative manner of presentation, the solution contains only the ₹additional depreciation₹.

| | ₹ |
|---|---|
| **1. Pre-acquisition profits and reserves of S Ltd.** | |
| Reserves | 25,000 |
| Profit and Loss Account | 15,000 |
| | 40,000 |
| H Ltd.'s = 4/5 (or 80%) x 40,000 | 32,000 |
| Minority Interest= 1/5 (or 20%) x 40,000 | 8,000 |
| **2. Profit on revaluation of assets of S Ltd.** | |
| Profit on Machinery ₹ (1,50,000 - 1,00,000) | 50,000 |
| *Less*: Loss on Furniture ₹ (20,000 - 15,000) | 5,000 |
| Net Profit on revaluation | 45,000 |
| H Ltd.'s share 4/5 x 45,000 | 36,000 |
| Minority Interest 1/5 x 45,000 | 9,000 |
| **3. Post-acquisition reserves of S Ltd.** | |
| Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 75,000 25,000) | 50,000 |
| H Ltd.'s share 4/5 x 50,000 | 40,000 |
| Minority interest 1/5 x 50,000 | 10,000 |
| **4. Post -acquisition profits of S Ltd.** | |
| Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = ₹ 25,000 - 15,000) | 10,000 |
| *Add:* Excess depreciation charged on furniture @ 15% | |
| on ₹ 5,000 i.e. (20,000 - 15,000) | 750 |
| | 10,750 |

| | ₹ |
|---|---:|
| *Less*: Under depreciation on machinery @ 10% on ₹ 50,000 i.e. (1,50,000 - 1,00,000) | (5,000) |
| Adjusted post-acquisition profits | 5,750 |
| H Ltd.'s share 4/5 x 5,750 | 4,600 |
| Minority Interest 1/5 x 5,750 | 1,150 |
| **5. Minority Interest** | |
| Paid-up value of (1,000 - 800) = 200 shares held by outsiders i.e. 200 x ₹ 100 (or 1,00,000 X 20%) | 20,000 |
| *Add:* 1/5th share of pre-acquisition profits and reserves | 8,000 |
| 1/5th share of profit on revaluation | 9,000 |
| 1/5th share of post-acquisition reserves | 10,000 |
| 1/5th share of post-acquisition profit | 1,150 |
| | 48,150 |
| **6. Cost of Control or Goodwill** | |
| Price paid by H Ltd. for 800 shares(A) | 1,60,000 |
| Intrinsic value of the shares- | |
| Paid-up value of 800 shares held by H Ltd. i.e. 800 x ₹ 100 (or 1,00,000 X 80%) | 80,000 |
| *Add:* 4/5th share of pre-acquisition profits and reserves | 32,000 |
| 4/5th share of profit on the revaluation | 36,000 |
| Intrinsic value of shares on the date of acquisition (B) | 1,48,000 |
| Cost of control or Goodwill (A - B) | 12,000 |

## Question 14

(a) *A Ltd. holds 80% of the equity capital and voting power in B Ltd. A Ltd. sells inventories costing ₹ 180 lacs to B Ltd at a price of ₹ 200 lacs. The entire inventories remain unsold with B Ltd. at the financial year end i.e. 31 March 20X1.*

(b) *A Ltd. holds 75% of the equity capital and voting power in B Ltd. A Ltd. purchases inventories costing ₹ 150 lacs from B Ltd at a price of ₹ 200 lacs. The entire inventories remain unsold with A Ltd. at the financial year end i.e. 31 March 20X1.*

*Suggest the accounting treatment for the above mentioned transactions in the consolidated financial statements of A Ltd. giving reference of the relevant guidance/standard.*

(*Source: Illustration 14, Study Material*)

**Answer**

*As per para 16 and 17 of AS 21, intragroup balances and intragroup transactions and resulting unrealized profits should be eliminated in full. Unrealized losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.*

*Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealized profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full. Unrealized losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered.*

*One also needs to see whether the intragroup transaction is "upstream" or "down-stream". Upstream transaction is a transaction in which the subsidiary company sells goods to holding company. While in the downstream transaction, holding company is the seller and subsidiary company is the buyer.*

*In the case of upstream transaction, since the goods are sold by the subsidiary to holding company; profit is made by the subsidiary company, which is ultimately shared by the holding company and the minority shareholders. In such a transaction, if some goods remain unsold at the balance sheet date, the unrealized profit on such goods should be eliminated from minority interest as well as from consolidated profit on the basis of their share-holding besides deducting the same from unsold inventory.*

*But in the case of downstream transaction, the whole profit is earned by the holding company, therefore, whole unrealized profit should be adjusted from unsold inventory and consolidated profit and loss account only irrespective of the percentage of the shares held by the parent.*

***Using above mentioned guidance, following adjustments would be required:***

(a) *This would be the case of downstream transaction. In the consolidated profit and loss account for the year ended 31 March 20X1, entire transaction of sale and purchase of ₹ 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales).*

*Further, the unrealized profits of ₹ 20 lacs (i.e. ₹ 200 lacs - ₹ 180 lacs), would be eliminated from the consolidated financial statements for financial year ended 31 March 20X1, by reducing the consolidated profits/ increasing the consolidated losses, and reducing the value of closing inventories as of 31 March 20X1.*

(b) *This would be the case of upstream transaction. In the consolidated profit and loss account for the year ended 31 March 20X1, entire transaction of sale and purchase of ₹ 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales). Further, the unrealized profits of ₹ 50 lacs (i.e. ₹ 200 lacs - ₹ 150 lacs),*

*would be eliminated in the consolidated financial statements for financial year ended 31 March 20X1, by reducing the value of closing inventories by ₹ 50 lacs as of 31 March 20X1. In the consolidated balance sheet as of 31 March 20X1, A Ltd.'s share of profit from B Ltd will be reduced by ₹ 37.50 lacs (being 75% of ₹ 50 lacs) and the minority's share of the profits of B Ltd would be reduced by ₹ 12.50 lacs (being 25% of ₹ 50 lacs).*

## Question 15

*H Ltd and its subsidiary S Ltd provide the following information for the year ended 31st March, 20X3:*

| | ***H Ltd.* (₹ in lacs)** | ***S Ltd.* (₹ in lacs)** |
|---|---:|---:|
| *Sales and other income* | *5,000* | *1,000* |
| *Increase in Inventory (closing less opening)* | *1,000* | *200* |
| *Raw material consumed* | *800* | *200* |
| *Wages and Salaries* | *800* | *150* |
| *Production expenses* | *200* | *100* |
| *Administrative Expenses* | *200* | *100* |
| *Selling and Distribution Expenses* | *200* | *50* |
| *Interest* | *100* | *50* |
| *Depreciation* | *100* | *50* |

*Other Information:*

*H Ltd. sold goods to S Ltd. of ₹ 120 lacs at cost plus 20%. Inventory of S Ltd. includes such goods valuing ₹ 24 lacs. Administrative expenses of S Ltd. include ₹ 5 lacs paid to H Ltd. as consultancy fees. Selling and distribution expenses of H Ltd. include ₹ 10 lacs paid to S Ltd. as commission.*

*H Ltd. holds 80% of equity share capital of ₹ 1,000 lacs in S Ltd. prior to 20X1-20X2. H Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by S Ltd. for the year 20X1-20X2.*

*Prepare a consolidated statement of profit and loss.*

(*Source: Illustration 15, Study Material*)

***Answer***

***Consolidated statement of profit and loss of H Ltd. and its subsidiary S Ltd. for the year ended on 31st March, 20X3***

| **Particulars** | **Note No.** | **₹ in Lacs** |
|---|:---:|---:|
| I. Revenue from operations | 1 | 5,865 |
| **II. Total Income** | | **5,865** |
| **III. Expenses** | | |
| Cost of material purchased/consumed | 2 | 1,180 |

| **Particulars** | **Note No.** | **₹ in Lacs** |
|---|---|---|
| Changes of inventories of finished goods | 3 | (1,196) |
| Employee benefit expense | 4 | 950 |
| Finance cost | 5 | 150 |
| Depreciation and amortization expense | 6 | 150 |
| Other expenses | 7 | 535 |
| **Total expenses** | | **1,769** |
| **IV. Profit before tax (II-III)** | | **4,096** |

**Notes to Accounts**

| | | **₹ in Lacs** | **₹ in Lacs** |
|---|---|---|---|
| 1. | Revenue from operations | | |
| | Sales and other income | | |
| | H Ltd. | 5,000 | |
| | S Ltd. | 1,000 | |
| | | 6,000 | |
| | *Less:* Inter-company sales | (120) | |
| | Consultancy fees received by H Ltd. from S Ltd. | (5) | |
| | Commission received by S Ltd. from H Ltd. | (10) | 5,865 |
| 2. | Cost of material purchased/consumed | | |
| | H Ltd. | 800 | |
| | S Ltd. | 200 | |
| | | 1,000 | |
| | *Less*: Purchases by S Ltd. from H Ltd. | (120) | 880 |
| | Direct expenses (Production) | | |
| | H Ltd. | 200 | |
| | S Ltd. | 100 | 300 |
| | | | 1,180 |
| 3. | Changes of inventories of finished goods | | |
| | H Ltd. | 1,000 | |
| | S Ltd. | 200 | |
| | 20<br>*Less:* Unrealized profits ₹ 24 lacs x 120 | (4) | 1,196 |
| 4. | Employee benefits and expenses Wages and salaries: | | |
| | H Ltd. | 800 | |
| | S Ltd. | 150 | 950 |
| 5. | Finance cost | | |
| | Interest: | | |
| | H Ltd. | 100 | |
| | S Ltd. | 50 | 150 |
| 6. | Depreciation | | |
| | H Ltd. | 100 | |
| | S Ltd. | 50 | 150 |

| | | ₹ in Lacs | ₹ in Lacs |
|---|---|---|---|
| 7. | Other expenses | | |
| | Administrative expenses | | |
| | H Ltd. | 200 | |
| | S Ltd. | 100 | |
| | *Less*: Consultancy fees received by H Ltd. from S Ltd. Selling and distribution Expenses: | (5) | 295 |
| | H Ltd. | 200 | |
| | S Ltd. | 50 | |
| | *Less*: Commission received by S Ltd. from H Ltd. | (10) | 240 |
| | | | 535 |

## Question 16

*Subsidiary B Ltd. provides the following balance sheet:*

| ***Particulars*** | ***Note No.*** | ***20X0 (₹)*** | ***20X1 (₹)*** |
|---|---|---|---|
| ***I. Equity and Liabilities*** | | | |
| ***(1) Shareholder's Funds*** | | | |
| *(a) Share Capital* | *1* | *5,00,000* | *5,00,000* |
| *(b) Reserves and Surplus* | *2* | *2,86,000* | *7,14,000* |
| ***(2) Current Liabilities*** | | | |
| *(a) Short term borrowings* | *3* | *--* | *1,70,000* |
| *(b) Trade Payables* | | *4,90,000* | *4,94,000* |
| *(c) Short-term provisions* | *4* | *3,10,000* | *4,30,000* |
| ***Total*** | | *15,86,000* | *23,08,000* |
| ***II. Assets*** | | | |
| ***(1) Non-current assets*** | | | |
| *(a) Property, Plant Equipment and* | *5* | *2,72,000* | *2,24,000* |
| *(b) Non-current Investment* | | | *4,00,000* |
| ***(2) Current assets*** | | | |
| *(a) Inventories* | | *5,97,000* | *7,42,000* |
| *(b) Trade Receivables* | | *5,94,000* | *8,91,000* |
| *(c) Cash & Cash Equivalents* | | *51,000* | *3,000* |
| *(d) Other current assets* | *6* | *72,000* | *48,000* |
| ***Total*** | | *15,86,000* | *23,08,000* |

| | | ***20X0 (₹)*** | ***20X1 (₹)*** |
|---|---|---|---|
| ***1.*** | ***Share capital*** | | |
| | *5,000 equity shares of ₹10 each, fully paid up* | *5,00,000* | *5,00,000* |
| ***2.*** | ***Reserves and Surplus*** | | |
| | *General Reserves* | *2,86,000* | *7,14,000* |
| ***3.*** | ***Short term borrowings*** | | |
| | *Bank overdraft* | *--* | *1,70,000* |

| ***Particulars*** | | ***Note No.*** | ***20X0 (₹)*** | ***20X1 (₹)*** |
|---|---|---|---|---|
| ***4.*** | ***Short term provisions*** | | | |
| | *Provision for taxation* | | *3,10,000* | *4,30,000* |
| ***5.*** | ***Property, plant and equipment*** | | | |
| | *Cost* | | *3,20,000* | *3,20,000* |
| | *Less: Depreciation* | | *(48,000)* | *(96,000)* |
| | *Total* | | *2,72,000* | *2,24,000* |
| ***6.*** | ***Other current Assets*** | | | |
| | *Prepaid expenses* | | *72,000* | *48,000* |

*Also consider the following information:*

(a) *B Ltd. is a subsidiary of A Ltd. Both the companies follow calendar year as the accounting year.*

(b) *A Ltd. values inventory on weighted average basis while B Ltd. used FIFO basis. To bring B Ltd.'s values in line with those of A Ltd, its value of inventory is required to be reduced by ₹12,000 at the end of 20X0 and ₹34,000 at the end of 20X1.*

(c) *B Ltd. deducts 1% from Trade Receivables as a general provision against doubtful debts.*

(d) *Prepaid expenses in B Ltd. include advertising expenditure carried forward of ₹ 60,000 in 20X0 and ₹ 30,000 in 20X1, being part of initial advertising expenditure of ₹ 90,000 in 20X0 which is being written off over three years. Similar amount of advertising expenditure of A Ltd. has been fully written off in 20X0.*

*Restate the balance sheet of B Ltd. as at 31st December, 20X1 after considering the above information, for the purpose of consolidation. Would restatement be necessary to make the accounting policies adopted by A Ltd. and B Ltd. uniform.*

(*Source: Illustration 16, Study Material*)

**Answer**

**As per para 20 and 21 of AS 21, Consolidated financial statements:**

Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements when they are used in preparing the consolidated financial statements.

Accordingly in the given case, restatement would be required to make the accounting policies of A Ltd and B Ltd uniform.

**Adjusted reserves of B Ltd.:**

| | ₹ | ₹ |
|---|---|---|
| Reserves as given | | 7,14,000 |
| *Add:* Provision for doubtful debts | | |
| {[8,91,000/99 X 100]-8,91,000} | | 9,000 |
| | | 7,23,000 |
| *Less:* Reduction in value of Inventory | 34,000 | |
| Advertising expenditure to be written off | 30,000 | (64,000) |
| Adjusted reserves | | 6,59,000 |

**Note:** No adjustment would be required in respect of opening inventory of B Ltd as that will not have any impact on P&L.

***Restated Balance Sheet of B Ltd. as at 31st December, 20X1***

| **Particulars** | **Note No.** | **(₹)** |
|---|---|---|
| **I. Equity and Liabilities** | | |
| **(1) Shareholder's Funds** | | |
| (a) Share Capital | 1 | 5,00,000 |
| (b) Reserves and Surplus | 2 | 6,59,000 |
| **(2) Current Liabilities** | | |
| (a) Short term borrowings | 3 | 1,70,000 |
| (b) Trade Payables | | 4,94,000 |
| (c) Short-term provision | 4 | 4,30,000 |
| **Total** | | 22,53,000 |
| **II. Assets** | | |
| **(1) Non-current assets** | | |
| (a) Property, Plant and Equipment | 5 | 2,24,000 |
| (b) Non-current Investment | | 4,00,000 |
| **(2) Current assets** | | |
| (a) Inventories | 6 | 7,08,000 |
| (b) Trade Receivables | 7 | 9,00,000 |
| (c) Cash & Cash Equivalents | | 3,000 |
| (d) Other current assets | 8 | 18,000 |
| **Total** | | 22,53,000 |

**Notes to Accounts**

| | | | **20X1 (₹)** |
|---|---|---|---|
| **1.** | **Share capital** | | |
| | 5,000 equity shares of Rs 10 each, fully paid up | | 5,00,000 |
| **2.** | **Reserves and Surplus** | | |
| | General Reserves (refer to WN) | | 6,59,000 |
| **3.** | **Short term borrowings** | | |
| | Bank overdraft | | 1,70,000 |
| **4.** | **Short term provisions** | | |
| | Provision for taxation | | 4,30,000 |
| **5.** | **Property, plant and equipment** | | |
| | Cost | | 3,20,000 |
| | *Less:* Depreciation | | (96,000) |
| | Total | | 2,24,000 |
| **6.** | **Inventory** | | |
| | Actual inventory | | 7,42,000 |
| | *Less:* Change in method of valuation | | (34,000) |
| | Total | | 7,08,000 |
| **7.** | **Trade receivables** | | |
| | Actual trade receivables | | 8,91,000 |
| | *Add:* Adjustment for provision | | 9,000 |
| | Total | | 9,00,000 |
| **8.** | **Other current Assets** | | |
| | Prepaid expenses | | 48,000 |

## Question 17

Hemant Ltd. purchased 80% shares of Power Ltd. on 1st January, 20X1 for ₹2,10,000. The issued capital of Power Ltd., on 1st January, 20X1 was ₹ 1,50,000 and the balance in the Profit & Loss Account was ₹90,000. During the year ended 31st December, 20X1, Power Ltd. earned a profit of ₹ 30,000 and at year end, declared and paid a dividend of ₹ 22,500. What is the amount of minority interest as on 1st January, 20X1 and 31st December, 20X1? Also compute goodwill/ capital reserve at the date of acquisition.

(*Source: Practical Question 6, Study Material*)

**Answer**

Total dividend paid is ₹ 22,500 (out of post-acquisition profits), hence dividend received by Hemant will be credited to P & L account. Hemant Ltd.'s share of dividend = ₹ 22,500 X 80% = ₹ 18,000

| **Goodwill on consolidation (at the date of acquisition):** | ₹ | ₹ |
|---|---|---|
| Cost of shares | | 2,10,000 |
| *Less:* Face value of capital i.e. 80% of capital | 1,20,000 | |
| *Add:* Share of capital profits [90,000 X 80 %] | 72,000 | (1,92,000) |
| Goodwill | | 18,000 |
| ***Minority interest on:*** | | |
| - **1st January, 20X1:** | | |
| 20% of ₹ 2,40,000 [1,50,000 + 90,000] | | 48,000 |
| - **31st December, 20X1:** | | |
| 20% of ₹ 2,47,500 [1,50,000 + 90,000 + 30,000 - 22,500] | | 49,500 |

## Question 18

King Ltd. acquires 70% of equity shares of Queen Ltd. as on 31st March, 20X1 at a cost of ₹ 140 lakhs. The following information is available from the balance sheet of Queen Ltd. as on 31st March, 20X1:

| | ***₹ in lakhs*** |
|---|---|
| *Property, plant and equipment* | *240* |
| *Investments* | *110* |
| *Current Assets* | *140* |
| *Loans & Advances* | *30* |
| *15% Debentures* | *180* |
| *Current Liabilities* | *100* |

*The following revaluations have been agreed upon (not included in the above figures):*

Property, plant and equipment- up by 20% and Investments- down by 10%.

King Ltd. purchased the shares of Queen Ltd. @ ₹20 per share (Face value - ₹10).

Calculate the amount of goodwill/capital reserve on acquisition of shares of Queen Ltd.

(*Source: Practical Question 7, Study Material*)

**Answer**

Revalued net assets of Queen Ltd. as on 31st March, 20X1

| | ***₹ in lakhs*** | ***₹ in lakhs*** |
|---|---|---|
| PPE [240 X 120%] | | 288 |
| Investments [110 X 90%] | | 99 |
| Current Assets | | 140 |
| Loans and Advances | | 30 |
| Total Assets after revaluation | | 557 |
| *Less:* 15% Debentures | 180.0 | |
| Current Liabilities | 100.0 | (280) |
| Equity / Net Worth | | 277 |

| | ₹ in lakhs | ₹ in lakhs |
|---|---|---|
| King Ltd.'s share of net assets (70% of 277) | | 193.9 |
| King Ltd.'s cost of acquisition of shares of Queen Ltd. | | |
| (₹140 lakhs) | | (140) |
| Capital reserve | | 53.9 |

## Question 19

From the following information, determine Minority Interest on the date of acquisition and on the date of consolidation in each case:

| *Case* | *Subsidiary Company* | *% of Share owned* | *Cost* | *Date Acquisition of 01-01-20X1* | | *Consolidation date 31-12-20X1* | |
|---|---|---|---|---|---|---|---|
| | | | | *Share Capital* | *Profits and Loss* | *Share Capital* | *Profit and Loss A/c* |
| | | | | ₹ | ₹ | ₹ | ₹ |
| *Case-A* | *X* | *90%* | *2,00,000* | *1,50,000* | *75,000* | *1,50,000* | *85,000* |
| *Case-B* | *Y* | *75%* | *1,75,000* | *1,40,000* | *60,000* | *1,40,000* | *20,000* |
| *Case-C* | *Z* | *70%* | *98,000* | *40,000* | *20,000* | *40,000* | *20,000* |
| *Case-D* | *M* | *95%* | *75,000* | *60,000* | *35,000* | *60,000* | *55,000* |

(*Source: Practical Question 8, Study Material*)

**Answer**

Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case, it should be equal to Share Capital + Profit & Loss A/c

A = Share capital on 1.1.20X1

B = Profit & loss account balance on 1.1.20X1

C = Share capital on 31.12.20X1

D = Profit & loss account balance on 31.12.20X1

| | **Minority % Shares Owned [E]** | **Minority interest as at the date of acquisition [E] x [A + B] ₹** | **Minority interest as at the date of consolidation [E] X [C + D] ₹** |
|---|---|---|---|
| Case A [100-90] | 10 % | 22,500 | 23,500 |
| Case B [100-75] | 25 % | 50,000 | 40,000 |
| Case C [100-70] | 30 % | 18,000 | 18,000 |
| Case D [100-95] | 5% | 4,750 | 5,750 |

## Question 20

A Ltd acquired 1,600 ordinary shares of ₹100 each of B Ltd on 1st July, 20X1. On 31st December, 20X1, the balance sheets of the two companies were as given below:

**Balance Sheet of A Ltd. and its subsidiary, B Ltd.**
**as at 31st December, 20X1**

| *Particulars* | *Note No.* | *A Ltd. (₹)* | *B Ltd. (₹)* |
|---|---|---|---|
| ***I. Equity and Liabilities*** | | | |
| ***(1) Shareholder's Funds*** | | | |
| *(a) Share Capital* | *1* | *5,00,000* | *2,00,000* |
| *(b) Reserves and Surplus* | *2* | *2,97,200* | *1,82,000* |

| **Particulars** | **Note No.** | **A Ltd. (₹)** | **B Ltd. (₹)** |
|---|---|---|---|
| **(2) Current Liabilities** | | | |
| (a) Trade Payables | | 47,100 | 17,400 |
| (b) Short term borrowings | 3 | 80,000 | |
| **Total** | | 9,24,300 | 3,99,400 |
| **II. Assets** | | | |
| **(1) Non-current assets** | | | |
| (a) Property, Plant and Equipment | 4 | 3,90,000 | 3,15,000 |
| (b) Non-current Investments | 5 | 3,40,000 | -- |
| **(2) Current assets** | | | |
| (a) Inventories | | 1,20,000 | 36,400 |
| (b) Trade receivables | | 59,800 | 40,000 |
| (c) Cash & Cash equivalents | 6 | 14,500 | 8,000 |
| **Total** | | 9,24,300 | 3,99,400 |

***Notes to Accounts***

| | | **A Ltd. ₹** | **B Ltd. ₹** |
|---|---|---|---|
| **1.** | **Share Capital** | | |
| | 5,000 shares of ₹100 each, fully paid up | 5,00,000 | - |
| | 2,000 shares of ₹100 each, fully paid up | - | 2,00,000 |
| | Total | 5,00,000 | 2,00,000 |
| **2.** | **Reserves and Surplus** | | |
| | General Reserves | 2,40,000 | 1,00,000 |
| | Profit & loss | 57,200 | 82,000 |
| | Total | 2,97,200 | 1,82,000 |
| **3.** | **Short term borrowings** | | |
| | Bank overdraft | 80,000 | — |
| **4.** | **Property plant and equipment** | | |
| | Land and building | 1,50,000 | 1,80,000 |
| | Plant & Machinery Total | 2,40,000 | 1,35,000 |
| | | 3,90,000 | 3,15,000 |
| **5.** | **Non-current Investments** | 3,40,000 | -- |
| | Investment in B Ltd (at cost) | | |
| **6.** | **Cash & Cash equivalents** | 14,500 | 8,000 |
| | Cash | | |

The Profit & Loss Account of B Ltd. showed a credit balance of ₹BQ,000 on 1st January, 20X1 out of which a dividend of 10% was paid on 1st August, 20X1; A Ltd. credited the dividend received to its Profit & Loss Account. The Plant & Machinery which stood at ₹ 1,50,000 on 1st January, 20X1 was considered as worth ₹ 1,80,000 on 1st July, 20X1; this figure is to be considered while consolidating the Balance Sheets. The rate of depreciation on plant & machinery is 10% (computed on the basis of useful lives).

Prepare consolidated Balance Sheet as at 31st December, 20X1.

(*Source: Practical Question 9, Study Material*)

**Answer:**

***Consolidated Balance Sheet of A Ltd. and its subsidiary, B Ltd.***
***as at 31st December, 20X1***

| **Particulars** | **Note No.** | **(₹)** |
|---|---|---|
| **I. Equity and Liabilities** | | |
| **(1) Shareholder's Funds** | | |
| (a) Share Capital | 1 | 5,00,000 |
| (b) Reserves and Surplus | 2 | 3,08,800 |
| **(2) Minority Interest** | | 83,600 |
| **(3) Current Liabilities** | | |
| (a) Trade Payables | 3 | 64,500 |
| (b) Short term borrowings | 4 | 80,000 |
| **Total** | | 10,36,900 |
| **II. Assets** | | |
| **(1) Non-current assets** | | |
| (a) Property, Plant and Equipment | 5 | 7,41,000 |
| (b) Intangible assets | 6 | 17,200 |
| **(2) Current assets** | | |
| (a) Inventories | 7 | 1,56,400 |
| (b) Trade receivables | 8 | 99,800 |
| (c) Cash & Cash equivalents | 9 | 22,500 |
| **Total** | | 10,36,900 |

**Notes to Accounts**

| | | | | ₹ |
|---|---|---|---|---|
| **1.** | **Share Capital** | | | |
| | 5,000 shares of ₹ 100 each | | | 5,00,000 |
| **2.** | **Reserves and Surplus** | | | |
| | Reserves | | 2,40,000 | |
| | Profit & loss (Refer to W.N 8) | | 68,800 | |
| | Total | | | 3,08,800 |
| **3.** | **Trade Payables** | | | |
| | A Ltd. | 47,100 | | |
| | *Add:* B Ltd | 17,400 | | |
| | Total | | | 64,500 |
| **4.** | **Short term borrowings** | | | |
| | Bank overdraft | | | 80,000 |
| **5.** | **Property, plant and equipment** | | | |
| | Land and building- A Ltd | 1,50,000 | | |
| | *Add:* Land and building- B Ltd | 1,80,000 | 3,30,000 | |
| | Plant & Machinery (Refer to W.N 7) | | 4,11,000 | |
| | Total | | | 7,41,000 |

| | | | | ₹ |
|---|---|---|---|---|
| **6.** | **Intangible assets** | | | |
| | Goodwill (refer to W.N 6) | | | 17,200 |
| **7.** | **Inventories** | | | |
| | A Ltd. | | 1,20,000 | |
| | B Ltd. | | 36,400 | |
| | Total | | | 1,56,400 |
| **8** | **Trade Receivables** | | | |
| | A Ltd. | 59,800 | | |
| | B Ltd. | 40,000 | | |
| | Total | | | 99,800 |
| **9** | **Cash & Cash equivalents** | | | |
| | Cash of A Ltd | | *14,500* | |
| | Add: cash of B Ltd. | | 8,000 | |
| | Total | | | 22,500 |

**Share holding Pattern**

| | |
|---|---|
| Total Shares of B Ltd | 2,000 shares |
| Shares held by A Ltd | 1,600 shares i.e. 80 % |
| Minority Shareholding | 400 shares i.e. 20 % |

**Working Notes:**

**1.** The dividend @ 10% on 1,600 shares - ₹ 16,000 received by A Ltd. should have been credited to the investment A/c, being out of pre-acquisition profits. A Ltd., must pass a rectification entry, viz.

| | |
|---|---|
| Profit & Loss Account | Dr. ₹ 16,000 |
| To Investment | ₹ 16,000 |

**2.** The Plant & Machinery of B Ltd. would stand in the books at ₹ 1,42,500 on 1st July, 20X1, considering only six months' depreciation on ₹ 1,50,000 total depreciation being ₹ 15,000. The value put on the assets being ₹ 1,80,000, there is an appreciation to the extent of ₹ 37,500 (1,80,000 - 1,42,500).

**3.** **Capital profits of B Ltd.**

| | ₹ | ₹ |
|---|---|---|
| Reserve on 1st January, 20X1 (Assumed there is no movement in reserves during the year and hence balance as on 1st January 20X1 is same as of 31st December 20X1) | | 1,00,000 |
| Profit & Loss Account Balance on 1st January, 20X1 | 30,000 | |
| *Less:* Dividend paid | (20,000) | 10,000 |
| Profit for 20X1: | | |
| Total ₹ 82,000 | | |
| Less: ₹10,000 | | |
| ₹ 72,000 | | |
| Proportionate upto 1st July, 20X1 on time basis (₹ 72,000/2) | | 36,000 |
| Appreciation in value of Plant & Machinery | | 37,500 |
| | | 1,83,500 |
| *Less:* 20% due to outsiders | | (36,700) |
| **Holding company's share** | | **1,46,800** |

**4. Revenue profits of B Ltd.:**

| | | |
|---|---|---|
| Profit after 1st July, 20X1 [(82,000 - 10,000) x ½ ] | | 36,000 |
| *Less:* Depreciation | | |
| 10% depreciation on ₹1,80,000 for 6 months | 9,000 | |
| *Less*: Depreciation already charged for 2nd half | | |
| year on 1,50,000 | (7,500) | (1,500) |
| | | 34,500 |
| *Less:* 1/5 due to outsiders | | (6,900) |
| **Share of A Ltd.** | | **27,600** |

**5. Minority interest:**

| | |
|---|---|
| Par value of 400 shares (2,00,000 X 20%) | 40,000 |
| *Add:* 1/5Capital Profits [WN 3] | 36,700 |
| 1/5 Revenue Profits [WN 4] | 6,900 |
| | 83,600 |

**6. Cost of Control:**

| | | |
|---|---|---|
| Amount paid for 1,600 shares | 3,40,000 | |
| *Less:* Dividend out of pre-acquisition profits | (16,000) | 3,24,000 |
| Par value of shares | 1,60,000 | |
| Capital Profits -share of A Ltd. [WN 3] | 1,46,800 | (3,06,800) |
| Cost of Control or Goodwill | | 17,200 |

**7. *Value of plant & Machinery:***

| | | |
|---|---|---|
| | | 2,40,000 |
| B Ltd. | 1,35,000 | |
| *Add:* Appreciation on 1st July, 20X1 [1,80,000 - (1,50,000 - 7,500)] | 37,500 | |
| | 1,72,500 | |
| *Add:* Deprecation for 2nd half charged on prerevalued value | 7,500 | |
| *Less:* Depreciation on ₹1,80,000 for 6 months | (9,000) | 1,71,000 |
| | | 4,11,000 |

**8. *Profit & Loss Account (Consolidated):***

| | | |
|---|---|---|
| A Ltd. as given | 57,200 | |
| *Less:* Dividend transferred to Investment A/c | (16,000) | 41,200 |
| Share of A Ltd. in revenue profits of B Ltd. (WN 4) | | 27,600 |
| | | 68,800 |

## Question 21

On 31st March, 20X1, the Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

**Balance Sheet of H Ltd.**
**and its subsidiary S Ltd. as at 31st March, 20X1**

| *Particulars* | *Note No.* | *H Ltd. (₹ in Lacs)* | *S Ltd. (₹in Lacs)* |
|---|---|---|---|
| ***I. Equity and Liabilities*** | | | |
| *(1) **Shareholder's Funds*** | | | |
| *(a) Share Capital* | *1* | *12,000* | *4,800* |

| **Particulars** | **Note No.** | **H Ltd. (₹ in Lacs)** | **S Ltd. (₹in Lacs)** |
|---|---|---|---|
| (b) Reserves and Surplus | 2 | 5,499 | 3,000 |
| (2) **Current Liabilities** | | | |
| (a) Trade payables | 3 | 1,833 | 1,014 |
| (b) Short term provisions | 4 | 855 | 394 |
| (c) Other current liabilities (Dividend payable) | | 1,200 | - |
| Total | | 21,387 | 9,208 |
| **II. Assets** | | | |
| (1) **Non-current assets** | | | |
| Property, Plant and Equipment | 5 | 9,468 | 5,486 |
| Non-current Investments (Shares in S Ltd.) | | 3,000 | |
| (2) **Current assets** | | | |
| (a) Inventories | | 3,949 | 1,956 |
| (b) Trade receivables | 6 | 2,960 | 1,562 |
| (c) Cash and cash equivalents | | 1,490 | 204 |
| (d) Short term loans and advances | 7 | 520 | |
| Total | | 21,387 | 9,208 |

***Notes to Accounts***

| | | **H Ltd. (₹ in lacs)** | **S Ltd. (₹ in lacs)** |
|---|---|---|---|
| **1.** | **Share Capital** | | |
| | Authorized share capital | 15,000 | 6,000 |
| | Equity shares of ₹10 each, fully paid up | | |
| | Issued and Subscribed: | | |
| | Equity shares of ₹10 each, fully paid up | 12,000 | 4,800 |
| **2.** | **Reserves and surplus** | | |
| | General Reserve | 2,784 | 1,380 |
| | Profit and Loss Account: | 2,715 | 1,620 |
| | Total | 5,499 | 3,000 |
| **3.** | **Trade Payables** | | |
| | Creditors | 1,461 | 854 |
| | Bills Payable | 372 | 160 |
| | | 1,833 | 1,014 |
| **4.** | **Short term provisions** | | |
| | Provision for Taxation | 855 | 394 |
| **5.** | **Property, plant and equipment** | | |
| | Land and Buildings | 2,718 | - |
| | Plant and Machinery | 4,905 | 4,900 |
| | Furniture and Fittings | 1,845 | 586 |
| | Total | 9,468 | 5,486 |

| | | ***H Ltd. (₹ in lacs)*** | ***S Ltd. (₹ in lacs)*** |
|---|---|---|---|
| ***6.*** | ***Trade receivables*** | | |
| | *Debtors* | *2,600* | *1,363* |
| | *Bills Receivable* | *360* | *199* |
| | *Total* | *2,960* | *1,562* |
| ***7.*** | ***Short term loans and advances*** | | |
| | *Sundry Advances* | *520* | *--* |

The following information is also provided to you:

*(a)* H Ltd. purchased 180 lakh shares in S Ltd. on 31st March, 20X0 when the balances of General Reserve and Profit and Loss Account of S Ltd. stood at ₹3,000 lakh and ₹ 1,200 lakh respectively.

*(b)* On 1st April, 20X0, S Ltd. declared a dividend @ 20% for the year ended 31st March, 20X0. H Ltd. credited the dividend received by it to its Profit and Loss Account.

*(c)* On 1st January, 20X1, S Ltd. issued 3 fully paid-up bonus shares for every 5 shares held out of balances of its general reserve as on 31st March, 20X0.

*(d)* On 31st March, 20X1, all the bills payable in S Ltd.'s balance sheet were acceptances in favour of H Ltd. But on that date, H Ltd. held only ₹ 45 lakh of these acceptances in hand, the rest having been endorsed in favour of its trade payables.

*(e)* On 31st March, 20X1, S Ltd.'s inventory included goods which it had purchased for ₹100 lakh from H Ltd. which made a profit @ 25% on cost.

Prepare a Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X1.

(*Source: Practical Question 10, Study Material*)

**Answer**

**Consolidated Balance Sheet of H Ltd.**
**and its subsidiary S Ltd. as at 31st March, 20X1**

| **Particulars** | **Note No.** | **(₹ in Lacs)** |
|---|---|---|
| **I. Equity and Liabilities** | | |
| (1) **Shareholder's Funds** | | |
| (a) Share Capital | 1 | 12,000 |
| (b) Reserves and Surplus | 2 | 7,159 |
| (2) **Minority Interest [W.N.6]** | | 3,120 |
| (3) **Current Liabilities** | | |
| (a) Trade payables | 3 | 2,802 |
| (b) Short term provisions | 4 | 1,249 |
| (c) Other current liabilities | 5 | 1,200 |
| Total | | 27,530 |
| **II. Assets** | | |
| (1) **Non-current assets** | | |
| Property, Plant and Equipment | 6 | 14,954 |
| (2) **Current assets** | | |
| (a) Inventories | 7 | 5,885 |
| (b) Trade receivables | 8 | 4,477 |
| (c) Short term loans and advances | 9 | 520 |
| (d) Cash and cash equivalents | 10 | 1,694 |
| Total | | 27,530 |

**Notes to Accounts**

| | | | | | (₹ in lacs) | (₹ in lacs) |
|---|---|---|---|---|---|---|
| **1.** | **Share Capital** | | | | | |
| | Authorized share capital | | | | | 15,000 |
| | Equity shares of ₹10 each, fully paid up | | | | | |
| | Issued and Subscribed: | | | | | |
| | Equity shares of ₹ 10 each, fully paid up | | | | | 12,000 |
| | Total | | | | | 12,000 |
| **2.** | **Reserves and surplus** | | | | | |
| | Capital Reserve (Note 5) | | | | 1,320 | |
| | General Reserve (2,784 + 108) Profit and Loss Account: | | | | 2,892 | |
| | H Ltd. | | 2,715 | | | |
| | *Less*: Dividend wrongly credited 360 | | | | | |
| | Unrealized Profit | 20 | (380) | | | |
| | | | 2,335 | | | |
| | *Add*: Share in S Ltd.'s Revenue profits | | 612 | | 2,947 | |
| | Total | | | | | 7,159 |
| **3.** | **Trade payables** | | | | | |
| | Creditors | | | | | |
| | H Ltd. | | | 1,461 | | |
| | S Ltd. | | | 854 | 2,315 | |
| | Bills Payable H Ltd. | | | ₹ 372 | | |
| | S Ltd. | | | ₹ 160 | | |
| | | | | ₹ 532 | | |
| | *Less:* Mutual owing | | | ₹ (45) | 487 | 2,802 |
| **4.** | **Short term provisions** | | | | | |
| | Provision for Taxation | | | | | |
| | H Ltd. | | | | 855 | |
| | S Ltd. | | | | 394 | |
| | Total | | | | | 1,249 |
| **5.** | **Other current liabilities** | | | | | |
| | Dividend payable H Ltd. | | | | | 1,200 |
| **6.** | **Property, plant and equipment** | | | | | |
| | Land and Buildings | | | | | |
| | H Ltd. | | | | 2,718 | |
| | Plant and Machinery H Ltd. | | | ₹ 4,905 | | |
| | S Ltd. | | | ₹ 4,900 | 9,805 | |
| | Furniture and Fittings H Ltd. | | | ₹ 1,845 | | |
| | S Ltd. | | | ₹ 586 | 2,431 | |
| | Total | | | | | 14,954 |
| **7.** | **Inventories** | | | | | |
| | Stock | | | | | |
| | H Ltd. | | | | 3,949 | |
| | S Ltd. | | | | 1,956 | |
| | | | | | 5,905 | |

| | | (₹ in lacs) | (₹ in lacs) |
|---|---|---|---|
| | *Less:* Unrealized profit | J20) | 5,885 |
| **8.** | **Trade receivables** | | |
| | Debtors | | |
| | H Ltd. ₹ 2,600 | | |
| | S Ltd. ₹ 1,363 | 3,963 | |
| | Bills Receivable | | |
| | H Ltd. ₹ 360 | | |
| | S Ltd. ₹ 199 | | |
| | ₹ 559 | | |
| | *Less:* Mutual Owing ₹ (45) | 514 | 4,477 |
| **9.** | **Short term loans and advances** | | |
| | Sundry Advances | | 520 |
| **10.** | **Cash and cash equivalents** | | |
| | Cash and Bank Balances | | 1,694 |

**Share holding pattern of S Ltd.**

| | |
|---|---|
| Shares as on 31st March, 20X1 (Includes bonus shares issued on 1st January, 20X1) | 480 lakh shares (4,800 lakhs/ ₹ 10) |
| H Ltd.'s holding as on 1st April, 20X0 | 180 lakhs |
| *Add:* Bonus received on 1st January, 20X1 | 108 lakhs (180 / 5 x 3) |
| Total H Ltd.'s holding as on 31st March, 20X1 | 288 lakhs i.e. 60 % |
| Minority Shareholding | [288/480x100] 40% |

**Working Notes:**

**1. S Ltd.'s General Reserve Account**

| | ₹ in lakhs | | ₹ in lakhs |
|---|---|---|---|
| To Bonus to equity | | By Balance b/d | 3,000 |
| shareholders (WN-8) | 1,800 | By Profit and Loss A/c | 180 |
| To Balance c/d | 1,380 | (Balancing figure) | — |
| | 3,180 | | 3,180 |

***2.* S Ltd.'s Profit and Loss Account**

| | ₹ in lakhs | | ₹ in lakhs |
|---|---|---|---|
| To General Reserve | | By Balance b/d | 1,200 |
| [WN 1] | 180 | By Net Profit for the year* | 1,200 |
| To Dividend paid | | | |
| (20% on ₹3,000 lakhs) | 600 | (Balancing figure) | |
| To Balance c/d | 1,620 | | — |
| | 2,400 | | 2,400 |

*Out of ₹ 1,200 lakhs profit for the year, ₹ 180 lakhs has been transferred to reserves.

***3. Distribution of Revenue profits***

| | ₹ in lakhs |
|---|---|
| Revenue profits (W. N. 2) | 1,200 |
| *Less:* Share of H Ltd. 60% | (720) |
| (General Reserve ₹ 108 + Profit and Loss Account ₹ 612) | — |
| Share of Minority Shareholders (40%) | 480 |

***Note:*** *The question can also be solved by taking ₹ 1,020 lakhs as post acquisition Profit and Loss balance and ₹ 180 lakhs as post acquisition General Reserve balance. The final answer will be same.*

**4. Calculation of Capital Profits**

| | **₹ in lakhs** |
|---|---:|
| General Reserve on the date of acquisition less bonus shares (₹ 3,000 - ₹ 1,800) | 1,200 |
| Profit and loss account on the date of acquisition less | 600 |
| dividend paid (₹ 1,200 - ₹ 600) | 1,800 |

H Ltd.'s share = 60% of ₹ 1,800 lakhs = ₹ 1,080 lakhs

*Minority interest = ₹ 1,800 - ₹ 1,080 = ₹ 720 lakhs*

***5. Calculation of capital reserve***

| **₹ in lakhs** | |
|---|---:|
| Paid up value of shares held (60% of ₹4,800) | 2,880 |
| *Add:* Share in capital profits [WN 4] | 1,080 |
| | 3,960 |
| *Less:* Cost of shares less dividend received (₹ 3,000 - ₹ 360) | (2,640) |
| Capital reserve | 1,320 |

**6. Calculation of Minority Interest**

| | **II ₹ in lakhs** |
|---|---:|
| 40% of share capital (40% of ₹ 4,800) | 1,920 |
| *Add:* Share in revenue profits [WN 3] | 480 |
| Share in capital profits [WN 4] | 720 |
| | 3,120 |

**7.** ***Unrealized profit in respect of inventory***

*₹ 100 lakhs* $\frac{25}{125}$ *= ₹ 20 lakhs*

**8.** ***Computation of bonus to equity shareholders***

| | ₹ In lakhs |
|---|---:|
| Shares as on 31 March 20X1 including bonus share issued on 1 January 20X1 | 4800 |
| Or we can say these are 1 + $\frac{3}{5}$ or $\frac{8}{5}$ | |
| i.e. Shares before bonus issue should have been $\frac{4800}{8/5}$ | =3000 |
| Accordingly, bonus issue would be (4,800–3,000) | 1,800 |

# QUESTION BANK

## Question 22

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

**Balance Sheet**

as on 31st March 2015

| | *H Ltd.* | *S Ltd.* |
|---|---|---|
| Share Capital | 6,00,000 | 2,00,000 |
| Reserves and surplus | 1,00,000 | 1,50,000 |
| Non-Current Liabilities | 2,00,000 | 2,00,000 |
| Current Liabilities | 4,00,000 | 3,00,000 |
| **Total** | **13,00,000** | **8,50,000** |
| Non-Current Assets | | |
| Fixed Assets | 3,00,000 | 3,00,000 |
| Investment in 100% Share of S Ltd. Purchased on 31-03-2015 | 3,50,000 | |
| Current Assets | 6,50,000 | 5,50,000 |
| **Total** | **13,00,000** | **8,50,000** |

Share were purchased as on 31.03.2015. Prepare Consolidated Balance Sheet.

## Question 23

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

**Balance Sheet**

as on 31st March 2015

| | *H Ltd.* | *S Ltd.* |
|---|---|---|
| Share Capital | 10,00,000 | 5,00,000 |
| Reserves and surplus | 5,00,000 | 4,00,000 |
| Current Liabilities | 2,00,000 | 1,00,000 |
| **Total** | **17,00,000** | **10,00,000** |
| Investment in 90% Share of S Ltd. | 9,50,000 | |
| Other Assets | 7,50,000 | 10,00,000 |
| **Total** | **17,00,000** | **10,00,000** |

Share were purchased as on 31.03.2015. Prepare Consolidated Balance Sheet.

## Question 24

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

**Balance Sheet**

as on 31st March 2015

| | *H Ltd.* | *S Ltd.* |
|---|---|---|
| Share Capital | 20,00,000 | 12,00,000 |
| Reserves and surplus | 9,00,000 | 6,00,000 |
| Current Liabilities | 3,00,000 | 2,00,000 |
| **Total** | **32,00,000** | **20,00,000** |
| Investment in 90% Share of S Ltd. | 10,00,000 | |
| Other Assets | 22,00,000 | 20,00,000 |
| **Total** | **32,00,000** | **20,00,000** |

Share were purchased as on 31.03.2015. Prepare Consolidated Balance Sheet.

## Question 25

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

**Balance Sheet**

as on 31st March 2015

| | *H Ltd.* | *S Ltd.* |
|---|---|---|
| Equity Share Capital | 7,00,000 | 8,00,000 |
| Reserves and surplus | 15,00,000 | 2,00,000 |
| Current Liabilities | 3,00,000 | 1,00,000 |
| **Total** | **25,00,000** | **11,00,000** |

| | *H Ltd.* | *S Ltd.* |
|---|---|---|
| Investment in 80% Share of S Ltd. | 8,20,000 | |
| Current Assets | 16,80,000 | 11,00,000 |
| **Total** | **25,00,000** | **11,00,000** |

Share were purchased as on 31.03.2015. Prepare Consolidated Balance Sheet.

## Question 26

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

**Balance Sheet**

as on 31st March 2015

| | *H Ltd.* | *S Ltd.* |
|---|---|---|
| Share Capital | 15,00,000 | 10,00,000 |
| Reserves and surplus | 2,00,000 | 1,00,000 |
| Current Liabilities | 3,00,000 | 1,00,000 |
| **Total** | **20,00,000** | **12,00,000** |
| Investment in 70% Share of S Ltd. | 7,50,000 | |
| Current Assets | 12,50,000 | 12,00,000 |
| **Total** | **20,00,000** | **12,00,000** |

H Ltd. had purchased share in S Ltd. on 01.04.2014 when Balance in Reserve & Surplus of S Ltd. Were ₹4,000/-. Prepare Consolidated Balance Sheet of group on 31.03.2015

## Question 27

**Balance Sheet 31.3.2012**

| *Equity & Liabilities* | H | S |
|---|---|---|
| *Shareholder Funds* | | |
| Share capital | 2,00,000 | 1,00,000 |
| Profit & Loss a/c | 70,000 | 30,000 |
| *Current Liabilities* | | |
| Creditors | 60,000 | 20,000 |
| | **3,30,000** | **1,50,000** |
| | H | S |
| *Non Current Assets* | | |
| Fixed Assets | 1,00,000 | 1,20,000 |
| Investment 60% | 1,90,000 | — |
| *Current Assets* | 40,000 | 30,000 |
| | **3,30,000** | **1,50,000** |

H Ltd. Purchase Investment on 1-4-2011 when Balance in Profit & Loss a/c of S Ltd. was ₹18,000.
Prepare consolidated Balance Sheet

## Question 28

**Balance Sheet as on 31.3.2015**

| *Equity & Liabilities* | *H Ltd.* | *S Ltd.* |
|---|---|---|
| *Shareholder Funds* | | |
| Equity Share Capital (₹10) | 100,000 | 50,000 |
| Profit & Loss A/c | 80,000 | 50,000 |
| *Current Liabilities* | | |
| Creditors | 85,000 | 140,000 |
| | **265000** | **240,000** |
| *Non Current Assets* | *H Ltd.* | *S Ltd.* |
| Fixed Assets | 100,000 | 80,000 |
| Investment in S 70% | 75,000 | — |
| *Current Assets* | 90,000 | 160,000 |
| | **265000** | **240,000** |

Investments were purchased on 1.10.2014 balance as 1.4.2014 in P & L A/cs was ₹40,000. Prepare Consolidated Balance sheet.

## Question 29

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

**Balance Sheet**

as on 31st March 2015

| | *H Ltd.* | *S Ltd.* |
|---|---|---|
| Share Capital | 10,00,000 | 8,00,000 |
| Reserves and Surplus | 6,00,000 | 4,00,000 |
| Creditors | 2,00,000 | 1,00,000 |
| **Total** | **18,00,000** | **13,00,000** |
| Fixed Assets | 5,00,000 | 6,00,000 |
| Investment 80% Share of S Ltd. | 11,00,000 | |
| Current Assets | 2,00,000 | 7,00,000 |
| **Total** | **18,00,000** | **13,00,000** |

H Ltd. had purchased share in S Ltd. on 01.04.2014 when Balance in Profit & Loss of S Ltd. was ₹ 2,50,000/- S Ltd. distributed Dividend on 01/10/2014 @ 10%. H Ltd. credited dividend to its Profit & Loss Account. Prepare Consolidated Balance Sheet.

## Question 30

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

**Balance Sheet**

as on 31st March 2015

| | *H Ltd.* | *S Ltd.* |
|---|---|---|
| Share Capital | 20,00,000 | 16,00,000 |
| Profit & Loss | 3,00,000 | 2,00,000 |
| General Reserves | 1,00,000 | 2,00,000 |
| Creditors | 6,00,000 | 5,00,000 |
| **Total** | **30,00,000** | **25,00,000** |
| Fixed Assets | 5,00,000 | 8,00,000 |
| Goodwill | 1,00,000 | 50,000 |
| Investment in S Ltd. 60% | 11,00,000 | |
| Current Assets | 13,00,000 | 16,50,000 |
| **Total** | **30,00,000** | **25,00,000** |

H Ltd. had purchased shares in S Ltd. on 01.01.2013. for ₹11,00,000/-. Balance in Profit & Loss and General Reserve on 01.04.2012 was ₹ 1,20,000/- each in S Ltd.

| **S Ltd. Paid** | **Date** | **Type** | **Rate** |
|---|---|---|---|
| | 01-10-2012 | Final | 10% |

Prepare Consolidated Balance Sheet.

## Question 31

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

**Balance Sheet**

as on 31st March 2015

| | *H Ltd.* | *S Ltd.* |
|---|---|---|
| Share Capital (₹ 10) | 10,00,000 | 9,00,000 |
| Reserves and Surplus: | | |
| General Reserves | 2,00,000 | 1,00,000 |
| Profit & Loss | 3,00,000 | 2,00,000 |
| Non-Current Liabilities | 3,00,000 | 3,00,000 |
| Current Liabilities | 1,00,000 | 1,00,000 |
| **Total** | **19,00,000** | **16,00,000** |
| Non-Current Assets | | |
| Fixed Assets | 4,00,000 | 6,00,000 |
| Investment in share of S Ltd. | 3,00,000 | |
| Current Assets | 12,00,000 | 10,00,000 |
| **Total** | **19,00,000** | **16,00,000** |

H Ltd. had purchased 50,000 shares of S Ltd. on 01.10.2013. Balance in Profit & Loss and General Reserve of S Ltd. was ₹ 1,50,000/- and ₹ 90,000/- respectively on 01.04.2013.

S Ltd. had distributed Bonus @ 1 shares for 8 held on 31.03.2014.

| S Ltd. paid Dividend | **Date** | **Rate** |
|---|---|---|
| | 01-11-2013 | 10% |
| | 01-10-2014 | 12% |

All dividends were credited to Profit & Loss of H Ltd. Prepare Consolidated Balance Sheet.

## Question 32

Following are Balance Sheet of H Ltd. and its subsidiary S Ltd. on 31st March, 2015:

**Balance Sheet**

as on 31st March 2015

| | *H Ltd.* | *S Ltd.* |
|---|---|---|
| Share Capital (₹ 10) | 7,00,000 | 5,00,000 |
| Reserves and Surplus | 6,00,000 | 4,00,000 |
| Current Liabilities | 3,00,000 | 3,00,000 |
| **Total** | **16,00,000** | **12,00,000** |
| Fixed Assets | 7,50,000 | 8,00,000 |
| Investment in share of S Ltd. | 5,00,000 | |
| Current Assets | 3,50,000 | 4,00,000 |
| **Total** | **16,00,000** | **12,00,000** |

H Ltd. held 30,000 shares of S Ltd. H Ltd. had purchased share of S Ltd. on 01-10-2014. Balance in Reserve & Surplus of S Ltd. on 01-04-2014 was ₹ 3,00,000/-

1. Bonus declared (distributed) ratio 1 : 4 by S Ltd. on 31-03-2015
2. Dividend paid by S Ltd. on 01-01-2015 @ 10%
3. Market Value of Fixed Assets of S Ltd. was increased by ₹ 50,000 on 01-10-2014. Depreciation rate @ 10% p.a. This Adjustment is yet to made in Balance Sheet.

Prepare Consolidated Balance Sheet.

## Question 33

On 31st March, 2015, the abridged Balance Sheets of H Ltd. and S Ltd. stood as follows:

| | H Ltd. (₹ in 000's) | S Ltd. (₹ in 000's) |
|---|---|---|
| Liabilities | | |
| Equity Share Capital - Authorised | 5,000 | 3,000 |
| Issued and subscribed in Equity Shares or 10 each fully paid | 4,000 | 2,400 |
| General Reserve | 928 | 690 |
| Profit and Loss Account | 1,305 | 810 |
| Trade payables | 611 | 507 |
| Provision for Taxation | 220 | 180 |
| Other Provisions | 65 | 17 |
| | 7,129 | 4,604 |
| Assets: | | |
| Plant and Machinery | 2,541 | 2,450 |
| Furniture and Fittings | 615 | 298 |
| Investment in the Equity Shares of S Ltd. | 1,500 | — |
| Inventory | 983 | 786 |
| Trade receivables | 820 | 778 |
| Cash and Bank Balances | 410 | 102 |
| Sundry Advances | 260 | 190 |
| | 7,129 | 4,604 |

Following Additional Information is available:

(a) H Ltd. purchased 90 thousand Equity Shares in S Ltd. on 1st April, 2014 at which date the following balances stood in the books of S Ltd. General Reserve ₹1,500 thousand; Profit and Loss Account ₹633 thousand.

(b) On 14th July, 2014 S Ltd. declared a dividend of 20% out of pre-acquisition profits and H Ltd. credited the dividend received to its Profit and Loss Account.

(c) On 1st November, 2014, S Ltd. issued 3 fully paid Equity Shares of 10 each, for every 5 shares held as bonus shares out of pre-acquisition General Reserve.

(d) On 31st March, 2015, the Inventory of S Ltd. included goods purchased for ₹50 thousand from H Ltd., which had made a profit of 25% on Cost.

(e) Details of Trade payables and Trade receivables:

| | **H Ltd. (₹ in 000's)** | **S Ltd. (₹ in 000's)** |
|---|---|---|
| Trade payables | | |
| Bills Payable | 124 | 80 |
| Sundry creditors | 487 | 427 |
| Trade receivables | | |
| Debtors | 700 | 683 |
| Bills Receivables | 120 | 95 |
| | 820 | 778 |

Prepare a consolidated Balance Sheet as on 31st March, 2015.

(*Practice Manual*)

**Answer**

**Consolidated Balance Sheet of H Ltd. with its subsidiary S Ltd. as on 31st March, 2012**

| Particulars | Note No. | (₹ in 000's) |
|---|---|---|
| **I. Equity and Liabilities** | | |
| (1) **Shareholder's Funds** | | |
| (*a*) Share Capital | 1 | 4,000 |
| (*b*) Reserves and Surplus | 2 | 3,063 |
| (2) **Minority Interest (W.N.6)** | | 1,560 |
| (3) **Current Liabilities** | | |
| Trade payables | 3 | 1,118 |
| Short term provisions | 4 | 482 |
| Total | | 10,223 |
| **II. Assets** | | |
| (1) **Non-current assets** | | |
| **Fixed assets** | | |
| Tangible assets | 5 | 5,904 |
| (2) **Current assets** | | |
| (*a*) Inventories | 6 | 1,759 |
| (*b*) Trade receivables | 7 | 1,598 |
| (*c*) Cash and cash equivalents | 8 | 512 |
| (*d*) Short term loans and advances | 9 | 450 |
| Total | | 10,223 |

**Notes to Accounts**

| | | | (₹ in 000's) | (₹ in 000's) |
|---|---|---|---|---|
| 1. | Share Capital | | | |
| | Authorised share capital | | | |
| | 5 lakhs equity shares of ₹ 10 each | | | 5,000 |
| | Issued, Subscribed and Paid up | | | |
| | 4 lakhs equity shares of ₹ 10 each fully paid | | | 4,000 |
| 2. | Reserves and surplus | | | |
| | Capital Reserve (Note 5) | | | |
| | General Reserve (₹ 928+₹ 54) | | 982 | |
| | Profit and Loss Account: | | | |
| | H Ltd. | ₹ 1,305 | | |
| | Add: Share in S Ltd | ₹ 306 | | |
| | | ₹ 1,611 | | |
| | Less: Dividend wrongly credited | ₹ (180) | | |
| | | ₹ 1,431 | | |
| | Less: Unrealised profit | ₹ (10) | 1,421 | 3,063 |

| | | | (₹ in 000's) | (₹ in 000's) |
|---|---|---|---|---|
| 3. | Trade payables | | | |
| | Sundry Creditors H Ltd. | ₹ 487 | | |
| | S Ltd. | ₹ 427 | 914 | |
| | Bills payable H Ltd. | ₹ 124 | | |
| | S Ltd. | ₹ 80 | 204 | 1,118 |
| 4. | Short –term provisions | | | |
| | Provision for Taxation H Ltd. | ₹ 220 | | |
| | S Ltd. | ₹ 180 | 400 | |
| | Other Provisions H Ltd | ₹ 65 | | |
| | S Ltd. | ₹ 17 | 82 | 482 |
| 5. | Tangible Assets | | | |
| | Plant and Machinery | | | |
| | H Ltd. | ₹ 2,541 | | |
| | S Ltd. | ₹ 2,450 | 4,991 | |
| | Furniture and fittings | | | |
| | H Ltd. | ₹ 615 | | |
| | S Ltd. | ₹ 298 | 913 | 5,904 |
| 6. | Inventories | | | |
| | Stock H Ltd. | ₹ 983 | | |
| | S Ltd. | ₹ 786 | | |
| | Less: Unrealised profit (₹ 50 x 1/5) | | (10) | 1,759 |
| 7 | Trade receivable | | | |
| | Debtors H Ltd. | ₹ 700 | | |
| | S Ltd. | ₹ 683 | 1,383 | |
| | Bills Receivables H Ltd. | ₹120 | | |
| | S Ltd. | ₹ 95 | 215 | 1,598 |
| 8 | Cash and cash equivalents | | | |
| | Cash and Bank Balances H Ltd | | 410 | |
| | S Ltd. | | 102 | 512 |
| 9 | Short term loans and advances | | | |
| | Sundry Advances H Ltd. | | 260 | |
| | S Ltd. | | 190 | 450 |

**Working Notes:**

1. **S Ltd. General Reserve**

| | (₹ in 000) | | (₹ in000) |
|---|---|---|---|
| To Bonus to equity shareholders $\left(\frac{2,400\times3}{8}\right)$ | 900 | By Balance b/d | 1,500 |
| | | By Profit and Loss A/c (Balancing figure) | 90 |
| To Balance c/d | 690 | | |
| | 1,590 | | 1,590 |

2. **S Ltd. Profit and Loss Account**

| | (₹in 000) | | (₹in 000) |
|---|---|---|---|
| To General Reserve | 90 | By Balance b/d | 633 |
| To Dividend paid on 14.7.2009 ₹ 1,500 × 20/100 | 300 | By Net Profit for the year (Balancing figure) | 600* |
| To Corporate Dividend Tax (11% of ₹ 300) | 33 | | |
| To Balance c/d | 810 | | |
| | 1,233 | | 1,233 |

* Out of ₹ 6,00,000 profit for the year, ₹ 90,000 has been transferred to reserves by S Ltd.

3. **Distribution of Revenue Profits**

| | ₹ in '000 |
|---|---|
| Revenue Profit as above | 600 |
| Share of H Ltd. (60%) | 360 |
| Share of Minority shareholders (₹ 600 – ₹ 360) | 240 |

4. **Computation of Capital Profits**

| | **₹ in 000** | **₹ in 000** |
|---|---|---|
| General Reserve on the date of acquisition | | 1,500 |
| Less: Bonus issue of shares | | 900 |
| | | 600 |
| Profit and Loss Account balance on the date of acquisition | 633 | |
| Less: Dividends paid ₹ 300 | | |
| Corporate tax paid ₹ 33 | (333) | 300 |
| | | 900 |
| Share of H Ltd. (60%) | | 540 |
| Share of Minority shareholders | | 360 |

5. **Computation of Capital Reserve**

| | | **₹ in '000** |
|---|---|---|
| 60% of share capital of S Ltd. | | 1,440 |
| Add: Share of H Ltd. in the capital profits as in working note (4) | | 540 |
| | | 1,980 |
| Less: Investments in S Ltd. | 1,500 | |
| Less: Dividends received out of pre- acquisition profits ₹ 300 × ₹ 60/100 | (180) | (1,320) |
| | | 660 |

6. **Calculation of Minority Interest**

| | | ₹ in '000 |
|---|---|---|
| 40% of share capital of S Ltd. | | 960 |
| Add: Share of Revenue Profits | | 240 |
| (Note 3) Share of Capital | | 360 |
| Profits (Note 4) | | 1,560 |

## Question 34

On 31st March, 2015 the summarized Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

| **Liabilities** | **H Ltd. (₹ in lakhs)** | **S Ltd. (₹ in lakhs)** |
|---|---|---|
| Share Capital: | | |
| Authorised | 15,000 | 6,000 |
| Issued and Subscribed: | | |
| Equity Shares of ₹ 10 each, fully paid up | 12,000 | 4,800 |
| General Reserve | 2,784 | 1,380 |
| Profit and Loss Account | 2,715 | 1,620 |
| Trade payables | 1,833 | 1,014 |
| Provision for Taxation | 855 | 394 |
| Payable Dividend | 1,200 | |
| | 21,387 | 9,208 |
| **Assets** | **H Ltd. ( in lakhs)** | **S Ltd. ( in lakhs)** |
| Land and Buildings | 2,718 | — |
| Plant and Machinery | 4,905 | 4,900 |
| Furniture and Fittings | 1,845 | 586 |
| Investments in shares in S Ltd. | 3,000 | — |
| Inventory | 3,949 | 1,956 |
| Trade receivables | 2,960 | 1,562 |
| Cash and Bank Balances | 1,490 | 204 |
| Sundry Advances | 520 | — |
| | 21,387 | 9,208 |

The following information is also provided to you:

(a) H Ltd. purchased 180 lakh shares in S Ltd. on 1st April, 2014 when the balances to General Reserve and Profit and Loss Account of S Ltd. stood at ₹ 3,000 lakh and ₹ 1,200 lakh respectively.

(b) On 31st May, 2014, S Ltd. declared a dividend @ 20% for the year ended 31st March, 2014. H Ltd. credited the dividend received by it to its Profit and Loss Account.

(c) On 1st January, 2015 S Ltd. issued 3 fully paid-up shares for every 5 shares held as bonus shares out of balances to its general reserve as on 31st March, 2014.

(d) Details of Trade payables and Trade receivables:

| | H Ltd. | S Ltd. |
|---|---|---|
| | (₹ in lakhs) | (₹ in lakhs) |
| Trade payables | | |
| Bills Payable | 372 | 160 |
| Sundry creditors | 1,461 | 854 |
| | 1,833 | 1,014 |
| Trade receivables | | |
| Debtors | 2,600 | 1,363 |
| Bills Receivables | 360 | 199 |
| | 2,960 | 1,562 |

(e) On 31st March, 2015 all the bills payable in S Ltd. 's balance sheet were acceptances in favour of H Ltd. But on that date, H Ltd. held only ₹ 45 lakh of these acceptances in hand, the rest having been endorsed in favour of its trade payables.

(f) On 31st March, 2015, S Ltd. 's inventory included goods which it had purchased for ₹ 100 lakh from H Ltd. which made a profit @ 25% on cost.

Prepare a Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 2015 bearing in mind the requirements of AS 21.

(*Practice Manual*)

## Question 35

The following are the balance sheets of a Holding Company and Subsidiary Company as at 31.3.1996 and 1997:

Holding Company's Balance Sheet as on 31 March ….

| *Liabilities* | *1996* ₹ | *1997* ₹ | *Assets* | *1996* ₹ | *1997* ₹ |
|---|---|---|---|---|---|
| Paid-up capital: | | | Bank Balance | 12,000 | 30,000 |
| 35,000 Shares of ₹ 10 each | 3,50,000 | 3,50,000 | Goodwill | 50,000 | 50,000 |
| Sundry Creditors | 39,000 | 35,000 | Land and Building at cost | 1,10,000 | 1,10,000 |
| Reserve | 41,000 | 57,000 | Machinery *less* deprecation | 80,000 | 75,000 |
| Profit and Loss Account | 67,000 | 80,000 | Stock | 40,000 | 47,000 |
| | | | Sundry Debtors | 55,000 | 60,000 |
| | | | Investment: | | |
| | | | 9,000 Shares of ₹ 10 each at cost | 1,50,000 | 1,50,000 |
| | 4,97,000 | 5,22,000 | | 4,97,000 | 5,22,000 |

Subsidiary Company's Balance Sheet as on 31 March …

| *Liabilities* | *1996* ₹ | *1997* ₹ | *Assets* | *1996* ₹ | *1997* ₹ |
|---|---|---|---|---|---|
| Paid-up Capital: | | | Goodwill | 40,000 | 40,000 |
| 10,000 shares of ₹10 each | 1,00,000 | 1,00,000 | Machinery less depreciation | 45,000 | 42,500 |
| Sundry Creditors | 10,000 | 10,000 | Stock | 25,000 | 30,000 |
| Reserve | 17,500 | 20,500 | Sundry Debtors | 22,000 | 32,000 |
| Profit and Loss Account | 12,000 | 28,500 | Bank Balance | 7,500 | 12,500 |
| | 1,39,500 | 1,57,000 | | 1,39,500 | 1,57,000 |

The shares in the subsidiary company were acquired on 31 March 1996. No dividend has been declared. Prepare consolidated balance sheet as at 31 March 1997.

## Question 36

From the balance sheets given below, prepare a consolidated balance sheet of X Ltd. and its subsidiary company Y Ltd. The interest of minority shareholders in Y Ltd. is to be shown as a separate item in the consolidated balance sheet.

**Balance Sheet of X Ltd. as on 31 March 1995**

| *Liabilities* | ₹ | *Assets* | ₹ |
|---|---|---|---|
| 12,000 Shares of ₹ 10 each | 1,20,000 | Freehold Building at cost | 80,000 |
| General Reserve | 25,000 | Plant and machinery at cost (40,000) *less* depreciation | 30,000 |
| Profit and Loss Account | 12,000 | Shares (2000) in subsidiary company at cost | 25,000 |
| Trade Creditors | 15,000 | Stock at cost | 10,000 |
| | | Trade Debtors | 22,000 |
| | | Bank | 5,000 |
| | 1,72,000 | | 1,72,000 |

**Balance Sheet of Y Ltd. as on 31 March 1995**

| *Liabilities* | ₹ | *Assets* | ₹ |
|---|---|---|---|
| 3,000 Shares of ₹ each | 30,000 | Leasehold property at cost (₹ 30,000) *less* deprecation | 25,000 |
| General Reserve as on 1-4-1994 | 6,000 | Plant and Machinery at cost (₹ 15,000) *less* depreciation | 10,000 |
| Profit and Loss Account | 9,000 | Stock at cost | 3,000 |
| Trade Creditors | 5,000 | Trade Debtors | 7,000 |
| | | Bank | 5,000 |
| | 50,000 | | 50,000 |

At the date of acquisition by X Ltd. of its holding of 2,000 shares in Y Ltd. the latter company had a credit balance of ₹ 6,000 in its profit and loss account.

## Question 37

The balance sheets of Hindustan Ltd. and Sundram Ltd. as on 31 March 1997 were as under:

| *Liabilities* | *Hindustan Ltd.* ₹ | *Sundram Ltd.* ₹ | *Assets* | *Hindustan Ltd.* ₹ | *Sundram Ltd.* ₹ |
|---|---|---|---|---|---|
| Shares of ₹ 100 each | 2,00,000 | 50,000 | Land and Building | 60,000 | — |
| General Reserve | 30,000 | 10,000 | Plant and Machinery | 2,00,000 | — |
| Profit and Loss Account: | | | Stock | 40,000 | 85,000 |
| Balance on 1.4.1996 | 40,000 | 20,000 | Sundry Debtors | 10,000 | 30,000 |
| Profit for 1996-97 | 50,000 | 25,000 | Bank | 10,000 | 10,000 |
| Creditors | 30,000 | 30,000 | 300 Shares in Sundram Ltd. at cost | 65,000 | — |
| Bank overdraft | 20,000 | — | Bills Receivable | — | 10,000 |
| Bills payable | 15,000 | — | | | |
| | 3,85,000 | 1,35,000 | | 3,85,000 | 1,35,000 |

Shares were acquired by Hindstan Ltd. as 1 October 1996. Bills receivable held by Sundram Ltd. are all accepted by Hindustan Ltd. Included in the debtors of Sundram Ltd. are ₹ 6,000 owing by Hindustan Ltd. in respect of goods supplied. Prepare consolidated balance sheet.

## Question 38

From the following information you are required to prepare a consolidated balance sheet of Karnataka Co. Ltd., and its subsidiary Bangalore Co. Ltd., as on 31.3.1998:

**Balance Sheet as on 31.3.1998**

| *Liabilities* | *Karnataka* ₹ | *Bangalore* ₹ | *Assets* | *Karnataka* ₹ | *Bangalore* ₹ |
|---|---|---|---|---|---|
| Share Capital: | | | Fixed Assets | | |
| Shares of ₹ 10 | 5,00,000 | 2,00,000 | Goodwill | 1,000,000 | — |
| Reserve & Surplus: | | | Plant & Machinery | 2,00,000 | 1,20,000 |
| General Reserves | 2,00,000 | 60,000 | Buildings | 2,00,000 | 1,30,000 |

| *Liabilities* | *Karnataka* ₹ | *Bangalore* ₹ | *Assets* | *Karnataka* ₹ | *Bangalore* ₹ |
|---|---|---|---|---|---|
| Surplus | 1,50,000 | 40,000 | Investments in 16,000 Shares of ₹ 10 each at Bangalore Ltd. | 2,00,000 | — |
| Secured Loans | | | Govt. Securities | — | 50,000 |
| Against Buildings | — | 80,000 | Current Assets: | | |
| Unsecured Loans | — | 40,000 | Stock | 80,000 | 50,000 |
| Current Liabilities & Provisions: | | | Debtors | 1,00,000 | 40,000 |
| Creditors | 1,00,000 | 60,000 | Bills Receivable | 50,000 | — |
| Bills Payable | 50,000 | 20,000 | Bank | 20,000 | 80,000 |
| | | | Cash | 50,000 | 30,000 |
| | 10,00,000 | 5,00,000 | | 10,00,000 | 5,00,000 |

(i) Bills Payable of Bangalore Ltd., include ₹ 10,000 due to Karnataka Ltd., which has discounted bills worth ₹ 5,000 with its Banker.

(ii) Sundry Creditors of Karnataka Co. Ltd. include ₹ 20,000 due to Bangalore Co Ltd.

(iii) The closing stock of Karnataka Ltd., include stock worth ₹ 60,000 supplied by Bangalore Ltd., which had invoiced to Karnataka Ltd., at cost *plus* 20% profit on cost.

(iv) On the date of purchase (1.1.1998) of 16,000 shares in Bangalore Ltd., by Karnataka Ltd., the balance sheet of Bangalore Ltd., showed general reserves of ₹ 20,000 and surplus of ₹ 10,000.

## Question 39

Jupiter Ltd. purchased control of Neptune Ltd. on 1.10.1997. Following are the balance sheets of two companies as at 31 March 1998:

| *Liabilities* | *Jupiter Ltd.* ₹ | *Neptune Ltd.* ₹ | *Assets* | *Jupiter Ltd.* ₹ | *Neptune Ltd.* ₹ |
|---|---|---|---|---|---|
| Equity Share Capital of ₹ 10 Share | 3,60,00 | 1,80,000 | Goodwill | 6,000 | 24,000 |
| General Reserve | 36,000 | 30,000 | Land & Building | 60,000 | 60,000 |
| Profit & Loss Account | 60,000 | 60,000 | Plant & Machinery | 1,20,000 | 1,08,000 |
| Creditors | 60,000 | 42,000 | Stock in trade | 70,500 | 60,000 |
| Bills Payable to Jupiter Ltd. | — | 6,000 | Debtors | 30,000 | 54,000 |
| Contingent Liability of Jupiter Ltd. for ₹ 9,000 for bills discounted | | | Investments in 13,500 Shares of Neptune Ltd. | 2,02,500 | — |
| | | | Cash at Bank | 27,000 | 12,000 |
| | 5,16,000 | 3,18,000 | | 5,16,000 | 3,18,000 |

Neptune Ltd. had on 1.4.1997 ₹ 30,000 in general reserve and ₹ 36,000 (Cr.) in profit and loss account. 10% dividend was received by Jupiter Ltd. in November from Neptune Ltd. for 1996-978 and this amount was credited to profit and loss Neptune Ltd. at ₹ 1,20,000 on the date of purchase was revalued at ₹ 1,44,000. Stock of Neptune Ltd. includes ₹ 9,600 received from Jupiter Ltd. on which it made a profit of 25% on cost. Prepare the consolidated balance sheet.

## Question 40

On 1 October 1998, H. Ltd. acquired 24,000 shares of ₹ 10 each in S. Ltd. at cost of ₹ 3,40,000. The balance sheets of two companies as on 30 June 1999 were as follows:

| *Liabilities* | *H. Ltd.* ₹ | *S. Ltd.* ₹ | *Assets* | *H. Ltd.* ₹ | *S. Ltd.* ₹ |
|---|---|---|---|---|---|
| Share Capital ( ₹ 10) | 15,00,000 | 4,00,000 | Goodwill | 5,00,000 | 1,40,000 |
| General Reserve (as per last year's account) | 6,00,000 | 3,00,000 | Land & Building | 6,50,00 | 2,00,000 |
| Profit & Loss Account | 4,00,000 | 1,70,000 | Machineries | 6,00,000 | 2,00,000 |
| Sundry Creditors | 3,60,000 | 84,000 | Stock | 3,00,000 | 80,000 |
| Bills Payable | 1,40,000 | 1,20,000 | Debtors | 3,50,000 | 2,70,000 |

| *Liabilities* | *H. Ltd.* ₹ | *S. Ltd.* ₹ | *Assets* | *H. Ltd.* ₹ | *S. Ltd.* ₹ |
|---|---|---|---|---|---|
| | | | Investments | 3,40,000 | — |
| | | | Bills Receivable | 1,20,000 | 60,000 |
| | | | Cash at Bank | 1,40,000 | 1,24,000 |
| | 30,00,000 | 10,74,000 | | 30,00,000 | 10,74,000 |

On 1 July 1998, the profit and loss account of S. Ltd. showed a credit balance of ₹ 80,000 out of which a dividend of 15% was paid in December 1998. The bills payable of S. Ltd. represent bills issued in favour of H. Ltd. which company still held ₹ 80,000 of the bills accepted of S. Ltd. The entire closing stock of S. Ltd. represents goods supplied by H. Ltd. at cost *plus* 20%. Prepare as consolidated balance sheet of two companies as on 30 June 1999.

## Question 41

The balance sheets of Ashish Ltd. and its subsidiary Anubhav Ltd. as on 31.3.1995 are as follows:

| *Liabilities* | *Ashish Ltd.* ₹ | *Anubhav Ltd.* ₹ | | *Assets* | *Ashish Ltd.* ₹ | *Anubhav Ltd.* ₹ |
|---|---|---|---|---|---|---|
| Share Capital: | | | | Building | 2,80,000 | 58,000 |
| Equity Shares of ₹ 10 each | 4,00,000 | 1,00,000 | | Plant & Machinery | 2,00,000 | 52,000 |
| General Reserve (1-4-1994) | 2,80,000 | 4,000 | | Furniture & Fixtures | 15,000 | 7,000 |
| Profit & Loss account | 1,70,000 | 72,000 | | Stock in trade | 75,000 | 42,000 |
| Sundry Creditors | 70,000 | 35,000 | | Sundry Debtors | 80,000 | 32,000 |
| | | | | Investments | 2,00,000 | — |
| | | | | Cash & Bank balances | 70,000 | 20,000 |
| | 9,20,000 | 2,11,000 | | | 9,20,000 | 2,11,000 |

Prepare a consolidated balance sheet together with a work sheet, having regard to the following:

(i) Ashish Ltd. had acquired in Anubhav Ltd. 8,000 shares as at 1 July 1994 at a cost of ₹2,00,000.

(ii) Stock-in-trade of Ashish Ltd. includes ₹ 6,000 relating to stock in tade at cost purchased from Anubhav Ltd. which follows the practice of charging 25% extra on the cost for determining the sale price.

(iii) Sundry creditors of Ashish Ltd. includes ₹ 10,000 on account of purchases from Anubhav Ltd. who follows the practice of charging 25% extra on the cost for detrermining the sale price.

(iv) Profit and loss account of Ashish Ltd. includes interim dividend declared after 1 July 1994 at the rate of 10% from Anubhav Ltd.

(v) Balance in profit and loss account as at 1 April 1994 of Anubhav Ltd. was ₹ 56,000, an interim dividend having been paid during the year out of the said undistributed profits.

(vi) Profits during the year 1994-95 have been earned on uniform basis throughout the year.

## Question 42

Prepare a consolidated balance sheet in the books of H Company Ltd. from the following balance sheets of H. Co. Ltd. and S. Co. Ltd. and given informations:

**Balance Sheets as on 31 March 1995**

| *Liabilities* | *H. Co. Ltd.* ₹ | *S. Co. Ltd.* ₹ |
|---|---|---|
| Preference Share Capital | 2,00,000 | 40,000 |
| Equity Share Capital of ₹ 100 each | 8,00,000 | 4,00,000 |
| General Reserve as on 1-4-94 | 2,00,000 | 1,20,000 |
| Profit and Loss Account | 2,80,000 | 1,80,000 |
| Creditors | 1,60,000 | 1,00,000 |
| Bills Payable | — | 40,000 |
| | 16,40,000 | 8,80,000 |
| *Assets* | | |
| Goodwill | 80,000 | 60,000 |
| Land and Building | 4,00,000 | 2,60,000 |
| Plant and Machinery | 3,20,00 | 1,80,000 |

| *Liabilities* | *H. Co. Ltd.* ₹ | *S. Co. Ltd.* ₹ |
|---|---|---|
| Debtors | 40,000 | 1,50,000 |
| Stock | 2,00,000 | 1,80,000 |
| 3,000 Shares in S Co. Ltd. purchased on 30-9-94 | 4,80,000 | — |
| Cash/Bank | 1,20,000 | 40,000 |
| Preliminary Expenses | — | 10,000 |
| | 16,40,00 | 8,80,000 |

*Informations*

(1)Profit and loss Account of S Co. Ltd showed a credit balance of ₹ 1,00,000 on 1 April 1994.

(2)A dividend of 15% was paid by S Co. Ltd. in October 1994 for the year ended 31 March 1994 which was credit to profit and loss account of H Co. Ltd.

(3)Included in creditors of S Co. Ltd. ₹ 40,000 for goods supplied by H Co. Ltd. Also included in the stock of S Co. Ltd. are goods to the value of ₹ 16,000 which were supplied by H Co. Ltd. at a profit of 25% on sales.

(4)Plant and Machinery were revalued at ₹ 3,00,000 which stood in the books at ₹ 2,00,000 in the beginning.

(5)There is contingent liability of ₹ 2,000 for a pending suit in the court in the books of H Co. Ltd.

## Question 43

A. Ltd. acquired 16,000 equity shares of ₹ 10 each in B. Ltd. on 1 October 1996 for ₹ 3,22,800. The balance sheets of the two companies as on 31 March 1997 were as follows:

| *Liabilities* | *A Ltd.* ₹ | *B Ltd.* ₹ | *Assets* | *A Ltd.* ₹ | *B Ltd.* ₹ |
|---|---|---|---|---|---|
| Share capital of ₹ 10 Shares | 5,00,000 | 2,00,000 | Land & Buildings | 1,80,000 | 1,90,000 |
| Reserves | 2,40,000 | 1,00,000 | Plant & Machinery | 2,40,000 | 1,35,000 |
| Profit & Loss Account | 57,200 | 82,000 | Investments | 3,60,000 | — |
| Bank Overdraft | 1,00,000 | — | Stock | 1,14,000 | 42,000 |
| Bills Payable | — | 13,000 | Debtors | 44,000 | 40,000 |
| Sundry Creditors | 69,800 | 20,000 | Bills Receivable | 14,800 | — |
| | | | Cash | 14,200 | 8,000 |
| | 9,67,000 | 41,5,000 | | 9,67,000 | 41,5,000 |

*Additional Information*

(i) The profit and loss account of B. ltd. showed a balance of ₹ 30,000 on 1 April 1996 out of which a dividend of 10% was paid on 1 November 1996. The dividend was correctly recorded by A Ltd.

(ii) The plant and machinery of B. Ltd. which stood at ₹ 1,50,000 on 1 April 1996 was considered worth ₹1,80,000 on the date of acquisition by A Ltd.

(iii) Profits may be assumed to have accrued evenly throughout the year. Prepare a consolidated balance sheet.

## Question 44

A Ltd. acquired 3,200 equity shares of ₹ 100 each on 31 March 1998. The balance sheet of two companies as on that date were:

| *Liabilities* | *A Ltd.* ₹ | *B Ltd.* ₹ | *Assets* | *A Ltd.* ₹ | *B Ltd.* ₹ |
|---|---|---|---|---|---|
| Equity Shares of ₹ 100 | 10,00,000 | 4,00,000 | Land & Buildings | 3,00,000 | 3,60,000 |
| Capital Reserves | — | 2,40,000 | Plant & Machinery | 4,80,000 | 2,18,800 |
| General Reserve | 4,80,000 | — | Investments in B Ltd. at cost | 6,80,000 | — |
| Profit & Loss Account | 1,14,400 | 72,000 | Stocks | 2,40,000 | 72,000 |
| Bank Overdraft | 1,60,000 | — | Sundry Debtors | 88,000 | 80,000 |
| Bills Payable (including ₹ 8,000 to A. Ltd.) | — | 16,800 | Bills Receivable (including ₹ 6,000 from B. Ltd.) | 31,600 | — |
| Sundry Creditors | 94,200 | 18,000 | Cash and Bank | 29,000 | 16,000 |
| | 18,48,600 | 7,46,800 | | 18,48,600 | 7,46,800 |

The following additional information is available:

(i) B Ltd. ahs made a bonus issue on 31 March 1998 of one equity share for every two shares held by its shareholders. This issue has not yet been taken into account.

(ii) Land buildings of B Ltd. are undervalued by ₹ 40,000 and plant and machinery of B Ltd. overvalued by ₹ 20,000. Values of these assets have to be adjusted accordingly.

(iii) Sundry Creditors of A Ltd. include ₹ 24,000 due to B Ltd. Prepare the consolidated balance sheet as at 31 March 1998.

## Question 45

The balance-sheets of H. Co. Ltd. and its subsidiary S. Co. Ltd. as on 31st March 1993 are as follows:

| *Liabilities* | *H Ltd.* ₹ | *S Ltd.* ₹ | *Assets* | *H Ltd.* ₹ | *S Ltd.* ₹ |
|---|---|---|---|---|---|
| Preference Share capital | 1,00,000 | — | Land | 3,56,000 | 70,000 |
| Equity Share Capital ₹ 100 fully paid | 5,00,000 | 1,50,000 | Properties | 3,76,000 | 40,000 |
| General Reserve | 3,40,000 | 6,000 | Plant and Machines | 1,40,000 | 91,300 |
| Profit and Loss Account | 3,60,000 | 1,08,000 | Investments in 1,200 shares of S. Co. on 1-4-1992 | 1,80,000 | |
| Creditors | 1,00,000 | 44,150 | Stock | 1,36,000 | 50,600 |
| Bills Payable | | 24,150 | Debtors and cash | 2,12,000 | 80,400 |
| | 14,00,000 | 3,32,300 | | 14,00,000 | 3,32,300 |

The other informations given are:

(a) Profit and loss account of H Co. includes an interim dividend of 10% received from S. Company.

(b) On 1-4-1992 profit and loss account of S. Co. stood at ₹ 77,500 and general reserve at ₹3,000. Also H. Co. revalued plant and machines of S. Co. at the time of purchase of shares by ₹ 20,000 more than its book value.

(c) Stock of H. Co. includes ₹ 8,000 of stock at cost purchased from S. Co. Further Debtors of S. Co. includes ₹ 24,000 for sales to H. Co. on which S. Co. made a profit of ₹ 6,000.

(d) S. Co. made a bonus issue during the year out of pre-acquisition profits for ₹ 60,000 not recorded in the books. Prepare consolidated balance sheet

## Question 46

Following are the balance sheets of H. Ltd. and S. Ltd. as at 31 March, 1997:

| *Liabilities* | *H Ltd.* ₹ | *S Ltd.* ₹ |
|---|---|---|
| Share capital: | | |
| Shares of ₹ 100 each | 5,00,000 | 2,00,000 |
| General reserve as on 1.4.1996 | 1,00,000 | 60,000 |
| Profit & loss account | 1,40,000 | 90,000 |
| Bills payable | — | 40,000 |
| Creditors | 80,000 | 50,000 |
| | 8,20,000 | 4,40,000 |
| *Assets* | | |
| Goodwill | 40,000 | 30,000 |
| Other fixed assets | 3,60,000 | 2,20,000 |
| 1,500 shares in S Ltd. at cost | 2,40,000 | — |
| Stock | 1,00,000 | 90,000 |
| Debtors | 20,000 | 75,000 |
| Cash at bank | 60,000 | 25,000 |
| | 8,20,000 | 4,40,000 |

The profit and loss account of S Ltd. showed a balance of ₹ 50,000 on 1 April, 1996. A dividend of 15% was paid on 15 October, 1996 for the year 1995-96. The dividend was credited by H Ltd. to its profit and loss account. H Ltd. acquired the shares on 1 October, 1996. The bills payable of S Ltd. were all issued in favour of H Ltd., which company got the bills discounted. Included in the creditors of S Ltd. are ₹ 20,000 for goods supplied by H Ltd. the stock of S Ltd. includes goods to the value of ₹ 8,000 which were supplied by H Ltd. at a profit of 33-1/3% on cost. Prepare consolidated balance sheet of H Ltd. and its subsidiary S Ltd. as on 31 March. 1997. Give all your working notes clearly.

## Question 47

The balance sheets of H Co. and S. Co. as on 31 March 1998 are as follows:

| *Liabilities* | *H Co.* ₹ | *S Co.* ₹ | *Assets* | *H Co.* ₹ | *S Co.* ₹ |
|---|---|---|---|---|---|
| Preference Share Capital | 3,00,000 | 40,000 | Goodwill | 70,000 | 60,000 |
| Equity Share Capital of ₹ 100 each | 9,00,000 | 4,00,000 | Land & Buildings | 6,00,000 | 2,60,000 |

| *Liabilities* | *H Co.* ₹ | *S Co.* ₹ | *Assets* | *H Co.* ₹ | *S Co.* ₹ |
|---|---|---|---|---|---|
| General Reserve as on 1-4-97 | 2,00,000 | 1,20,000 | Plant & Machinery | 3,30,000 | 1,80,000 |
| P & L Account | 2,80,000 | 1,80,000 | Investments : | | |
| Creditors | 1,60,000 | 1,00,000 | 3,000 shares in S. Co. (on 30.9.97) | 4,80,000 | — |
| Bills Payable | — | 40,000 | Debtors | 40,000 | 1,50,00 |
| | | | Stocks | 2,00,000 | 1,80,000 |
| | | | Cash | 1,20,000 | 40,000 |
| | | | Preliminary Exp. | — | 10,000 |
| | 18,40,000 | 8,80,000 | | 18,40,000 | 8,80,000 |

**Informations**: **1.** A dividend of 15% was paid by S Co. in October, 1997 for the year ended 31 March, 1997; **2.** Plant & Machinery of S. Co. in the beginning was ₹ 2,00,000. H. Co. revalued it by ₹ 1,00,000 more tat the time of purchase of shares; **3.** There was a bonus issue of ₹ 40,000 out of post-acquisition profits by S. Co.; **4.** Credit balance of P & L Account of S. Co on 1 April 1997 was ₹ 1,00,000; **5.** Included in creditors of S. Co. are goods to the value of ₹ 16,000 which were supplied by H Co. at profit of 25% on sales. Prepare consolidated balance sheet giving working notes.

## Question 48

H Ltd. acquire 70% of equity share of S Ltd. as on 1st January, 2011 at a cost of ₹5,00,000 when S Ltd. had an equity share capital of ₹5,00,000 and reserve and surplus of ₹40,000.

Both the companies follow calendar year as the accounting year.

In the four consecutive years, S Ltd. fared badly and suffered losses of ₹1,25,000, ₹2,00,000, ₹2,50,000 and ₹60,000 respectively.

Thereafter in 2015, S Ltd. experienced turnaround and registered an annual profit of ₹25,000. In the next two years i.e. 2016 and 2017, S Ltd. recorded annual profits of ₹50,000 and ₹75,000 respectively.

Show the Minority Interests and Cost of Control at the end of each year for the purpose of consolidation.

(*May 2019*) (*10 Marks*)

**Answer:**

The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. The excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered. Accordingly,

| *Year* | *Profit/ (Loss)* | *Minority Interest (30%)* | *Additional Consolidated P & L (Dr.) or Cr.* | *Minority's Share of losses borne by H Ltd.* | | *Cost of Control* |
|---|---|---|---|---|---|---|
| | | | | ₹ | *Balance* | |
| At the time of acquisition on 1.1.2011 | | 1,62,000 (W.N.) | - | | | 1,22,000 (W.N.) |
| 2011 | (1,25,000) | (37,500) | (87,500) | | | |
| Balance | | 1,24,500 | | | | |
| 2012 | (2,00,000) | (60,000) | (1,40,000) | | | 1,22,000 |
| Balance | | 64,500 | | | | |
| 2013 | (2,50,000) | (75,000) | (1,75,000) | | | 1,22,000 |
| | | (10,500) | | | | |
| | Loss of minority borne by Holding Co. | 10,500 | (10,500) | 10,500 | 10,500 | |

| *Year* | *Profit/ (Loss)* | *Minority Interest (30%)* | *Additional Consolidated P & L (Dr.) or Cr.* | *Minority's Share of losses borne by H Ltd.* | | *Cost of Control* |
|---|---|---|---|---|---|---|
| | | | | *₹* | *Balance* | |
| Balance | | Nil | (1,85,500) | | | |
| 2014 | (60,000) | (18,000) | (42,000) | | | 1,22,000 |
| | Loss of Minority borne by Holding Co. | 18,000 | (18,000) | 18,000 | 28,500 | |
| Balance | | Nil | (60,000) | | | |
| 2015 | 25,000 | 7,500 | 17,500 | | | 1,22,000 |
| | Profit share of minority adjusted against losses of minority absorbed by Holding Co. | (7,500) | 7,500 | (7,500) | 21,000 | |
| Balance | | Nil | 25,000 | | | |
| 2016 | 50,000 | 15,000 | 35,000 | (15,000) | 6,000 | 1,22,000 |
| | | (15,000) | 15,000 | | | |
| Balance | | Nil | 50,000 | | | |
| 2017 | 75,000 | 22,500 | 52,500 | (6,000) | Nil | 1,22,000 |
| | | (6,000) | 6,000 | | | |
| Balance | | 16,500 | 58,500 | | | |

**Working Note:**

Calculation of Minority interest and Cost of control on 1.1.2011

| | | *Share of Holding Co.* | *Minority Interest* |
|---|---|---|---|
| | *100%* | *70%* | *30%* |
| | *(₹)* | *(₹)* | *(₹)* |
| Share Capital | 5,00,000 | 3,50,000 | 1,50,000 |
| Reserve | 40,000 | 28,000 | 12,000 |
| | | 3,78,000 | 1,62,000 |
| *Less:* Cost of investment | | (5,00,000) | |
| Goodwill | | 1,22,000 | |

## Question 49

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 2016 for ₹2,80,000. The issued capital of ABC Ltd., on 1st January, 2016 was ₹2,00,000 and the balance in the Profit & Loss Account was ₹1,20,000.

During the year ended 31st December, 2016, ABC Ltd. earned a profit of ₹40,000 and at year end, declared and paid a dividend of ₹60,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd.

You are required to compute amount of minority interest as on 1st January, 2016 and 31st December, 2016?

(*MTP March 2018*) (*5 Marks*)

**Answer:**

Total dividend paid = ₹60,000

Out of post-acquisition profit = ₹40,000

Out of pre-acquisition profit = ₹20,000

Hence, 2/3rd of dividend received by XYZ will be credited to P & L and 1/3rd will be credited to Investment.

XYZ Ltd.'s share of dividend = ₹60,000 × 80% = ₹48,000

**In the books of XYZ Ltd.**

| | ₹ | ₹ |
|---|---|---|
| Bank A/c Dr. | 48,000 | |
| To Profit & Loss A/c | | 32,000 |
| To Investments in ABC Ltd. | | 16,000 |
| (Dividend received from ABC Ltd. 1/3 credited to investment A/c being out of capital profits - as explained above) | | |
| *Goodwill on Consolidation:* | | ₹ |
| Cost of shares less dividend out of capital profits | | 2,64,000 |
| Less: Face value of capital i.e. 80% of capital | 1,60,000 | |
| Share of capital profits [1,20,000 - 20,000 (dividend portion out of pre-acquisition profits)] X 80 % | 80,000 | 2,40,000 |
| Goodwill | | 24,000 |
| Minority interest on: | | 64,000 |
| 1st January, 2016: 20% of ₹3,20,000 [2,00,000 + 1,20,000] | | |
| 31st December, 2016: 20% of ₹3,00,000 [2,00,000 + 1,20,000 + 40,000 - 60,000] | | 60,000 |

## Question 50

A Ltd. acquired 70% of equity shares of B Ltd. on 1.4.2010 at cost of ₹10,00,000 when B Ltd. had an equity share capital of ₹10,00,000 and reserves and surplus of ₹80,000. In the four consecutive years, B Ltd. fared badly and suffered losses of ₹2,50,000, ₹4,00,000, ₹5,00,000 and ₹1,20,000 respectively. Thereafter in 2014-15, B Ltd. experienced turnaround and registered an annual profit of ₹50,000. In the next two years i.e. 2015-16 and 2016-17, B Ltd. recorded annual profits of ₹1,00,000 and ₹1,50,000 respectively.

You are required to compute the minority interests and cost of control at the end of each year for the purpose of consolidation.

(*MTP April 2018*) (*10 Marks*)

**Answer**:

The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. The excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered. Accordingly,

| Year | Profit/ (Loss) | Minority Interest (30%) | Additional Consolidated P & L (Dr.) Cr. | Minority's Share of losses borne by A Ltd. | | Cost of Control |
|---|---|---|---|---|---|---|
| | | | | ₹ | Balance | |
| At the time of acquisition in 2010 | | 3,24,000 (W.N.) | — | | | |
| 2010-11 | (2,50,000) | (75,000) | (1,75,000) | | | 2,44,000 (W.N.) |
| Balance | | 2,49,000 | | | | |
| 2011-12 | (4,00,000) | (1,20,000) | (2,80,000) | | | 2,44,000 |
| Balance | | 1,29,000 | | | | |
| 2012-13 | (5,00,000) | (1,50,000) | (3,50,000) | | | 2,44,000 |
| | | (21,000) | | | | |
| | Loss of minority borne by Holding Co. | 21,000 | (21,000) | 21,000 | 21,000 | |
| Balance | | Nil | (3,71,000) | | | |
| 2013-14 | (1,20,000) | (36,000) | (84,000) | | | 2,44,000 |
| | Loss of minority borne by Holding Co. | 36,000 | (36,000) | 36,000 | 57,000 | |
| Balance | | Nil | (1,20,000) | | | |
| 2014-15 | 50,000 | 15,000 | 35,000 | | | 2,44,000 |
| | Profit share of minority adjusted against losses of minority | (15,000) | 15,000 | (15,000) | 42,000 | |

| Year | Profit/ (Loss) | Minority Interest (30%) | Additional Consolidated P & L (Dr.) Cr. | Minority's Share of losses borne by A Ltd. | | Cost of Control |
|---|---|---|---|---|---|---|
| | | | | ₹ | Balance | |
| Balance | absorbed by Holding Co. | Nil | 50,000 | | | |
| 2015-16 | 1,00,000 | — | 1,00,000 | (30,000) | 12,000 | 2,44,000 |
| Balance | | Nil | | | | |
| 2016-17 | 1,50,000 | 45,000 | 1,05,000 | (12,000) | Nil | 2,44,000 |
| | | (12,000) | 12,000 | | | |
| Balance | | 33,000 | 1,17,000 | | | |

**Working Note:**

Calculation of Minority interest and Cost of control on 1.4.2010

| | 100% (₹) | Share of Holding Co. 70% (₹) | Minority Interest 30% (₹) |
|---|---|---|---|
| Share Capital | 10,00,000 | 7,00,000 | 3,00,000 |
| Reserve | 80,000 | 56,000 | 24,000 |
| | | 7,56,000 | 3,24,000 |
| Less: Cost of investment | | (10,00,000) | |
| Goodwill | | 2,44,000 | |

## Question 51

From the following data, determine the amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own Profit & Loss Account to be ₹2,00,000 in each case:

| Case | Subsidiary Company | % shares owned | Cost | Date of acquisition | | Consolidation Date | |
|---|---|---|---|---|---|---|---|
| | | | | 1.1.2016 | | 31.12.2016 | |
| | | | | Share Capital | Profit & Loss Account | Share Capital | Profit & Loss Account |
| | | | ₹ | ₹ | ₹ | ₹ | ₹ |
| Case 1 | A | 90% | 1,40,000 | 1,00,000 | 50,000 | 1,00,000 | 70,000 |
| Case 2 | B | 85% | 1,04,000 | 1,00,000 | 30,000 | 1,00,000 | 20,000 |
| Case 3 | C | 80% | 56,000 | 50,000 | 20,000 | 50,000 | 20,000 |
| Case 4 | D | 100% | 1,00,000 | 50,000 | 40,000 | 50,000 | 55,000 |

(*MTP April 2018*) (*5 Marks*)

**Answer:**

The balance in the Profit & Loss Account on the date of acquisition (1.1.2016) is Capital profit, as such the balance of Consolidated Profit & Loss Account shall be equal to Holding Co.'s profit.

On 31.12.2016 in each case the following amount shall be added or deducted from the balance of holding Co.'s Profit & Loss account.

| | % Share holding [K] | P & L as on 31.12.2016 [L] | P & L as on consolidation date [M] | P & L post acquisition [N] = [M]-[L] | Amount to be added/ (deducted) from holding's P&L [O] = [K] x [N] |
|---|---|---|---|---|---|
| 1 | 90% | 50,000 | 70,000 | 20,000 | 18,000 |
| 2 | 85% | 30,000 | 20,000 | (10,000) | (8,500) |
| 3 | 80% | 20,000 | 20,000 | Nil | Nil |
| 4 | 100 % | 40,000 | 55,000 | 15,000 | 15,000 |

## Question 52

Exe Ltd. acquires 70% of equity shares of Zed Ltd. as on 31st March, 2017 at a cost of ₹70 lakhs. The following information is available from the balance sheet of Zed Ltd. as on 31st March, 2017:

| | ₹ in lakhs |
|---|---|
| Fixed Assets | 120 |
| Investments | 55 |
| Current Assets | 70 |
| Loans & Advances | 15 |
| 15% Debentures | 90 |
| Current Liabilities | 50 |

The following revaluations have been agreed upon (not included in the above figures):

| | |
|---|---|
| Fixed Assets | Up by 20% |
| Investments | Down by 10% |

Zed Ltd. declared and paid dividend @ 20% on its equity shares as on 31st March, 2017. Exe Ltd. purchased the shares of Zed Ltd. @ ₹20 per share.

Calculate the amount of goodwill/capital reserve on acquisition of shares of Zed Ltd.

(*MTP October 2018*) (*5 Marks*)

**Answer:**

**Revalued net assets of Zed Ltd. as on 31st March, 2017**

| | *₹ in lakhs* | *₹ in lakhs* |
|---|---|---|
| Fixed Assets [120 X 120%] | | 144.0 |
| Investments [55 X 90%] | | 49.5 |
| Current Assets | | 70.0 |
| Loans and Advances | | 15.0 |
| Total Assets after revaluation | | 278.5 |
| *Less:* 15% Debentures | 90.0 | |
| Current Liabilities | 50.0 | (140.0) |
| Equity/Net Worth | | 138.5 |
| Exe Ltd.'s share of net assets (70% of 138.5) | | 96.95 |
| Exe Ltd.'s cost of acquisition of shares of Zed Ltd. | | |
| (₹70 lakhs – ₹7 lakhs*) | | 63.00 |
| Capital reserve | | 33.95 |

| | |
|---|---|
| * Total Cost of 70 % Equity of Zed Ltd | ₹70 lakhs |
| Purchase Price of each share | ₹20 |
| Number of shares purchased [70 lakhs/₹20] | 3.5 lakhs |
| Dividend @ 20 % i.e. ₹2 per share | ₹7 lakhs |

Since dividend received is for pre-acquisition period, it has been reduced from the cost of investment in the subsidiary company.

## Question 53

The following data is provided to you:

| Case | Subsidiary Company | % shares owned | Cost | Date of acquisition | | Consolidation Date | |
|---|---|---|---|---|---|---|---|
| | | | | | 1.1.2018 | | 31.12.2018 |
| | | | | Share Capital | Profits Loss Account | Share Capital | Profits Loss Account |
| | | | ₹ | ₹ | ₹ | ₹ | ₹ |
| Case 1 | A | 90% | 1,40,000 | 1,00,000 | 50,000 | 1,00,000 | 70,000 |
| Case 2 | B | 85% | 1,04,000 | 1,00,000 | 30,000 | 1,00,000 | 20,000 |
| Case 3 | C | 80% | 56,000 | 50,000 | 20,000 | 50,000 | 20,000 |
| Case 4 | D | 100% | 1,00,000 | 50,000 | 40,000 | 50,000 | 55,000 |

Determine in each case:

(1) Minority interest at the date of acquisition and at the date of consolidation.

(2) Goodwill or Capital Reserve.

(*RTP May, 2019*)

**Answer:**

**(1) Minority Interest** = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case it should be equal to Share Capital + Profit & Loss A/c.

| | Minority % Shares Owned<br>[E] | Minority interest as at the date of acquisition<br>[E] × [A+B] ₹ | Minority interest as at the date of consideration<br>[E] × [C + D] ₹ |
|---|---|---|---|
| Case 1 [100-90] | 10% | 15,000 | *17,000* |
| Case 2 [100-85] | 15% | *19,500* | 18,000 |
| Case 3 [100-80] | 20% | *14,00* | 14,000 |
| Case 4 [100-100] | Nil | *Nil* | Nil |

A = Share capital on 1.1.2018

B = Profit & loss account balance on 1.1.2018

C = Share capital on 31.12.2018

D = Profit & loss account balance on 1.1.2018

**(2) Calculation of Goodwill or Capital Reserve**

| | Shareholding<br>% [F] | Cost<br>[G] | Total Equity<br>[A]+[B] = [H] | Parent's Portion of equity<br>[F]x[H] | Goodwill<br>₹[G]-[H] | Capital Reserve<br>₹[H] - [G] |
|---|---|---|---|---|---|---|
| Case I | 90% | 1,40,000 | 1,50,000 | 1,35,000 | 5,000 | — |
| Case 2 | 85% | 1,04,000 | 1,30,000 | 1,10,500 | — | 6,500 |
| Case 3 | 80% | 56,000 | 70,000 | 56,000 | Nil | Nil |
| Case 4 | 100% | 1,00,000 | 90,000 | 90,000 | 10,000 | — |

## Question 54

From the following data, determine the amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own Profit & Loss Account to be ₹2,00,000 in each case:

| Case | Subsidiary Company | % shares owned | Cost ₹ | Date of acquisition | | Consolidation Date | |
|---|---|---|---|---|---|---|---|
| | | | | 1.1.2018 | | 31.12.2018 | |
| | | | | Share Capital ₹ | Profit & Loss Account ₹ | Share Capital ₹ | Profit & Loss Account ₹ |
| Case 1 | A | 90% | 1,40,000 | 1,00,000 | 50,000 | 1,00,000 | 70,000 |
| Case 2 | B | 85% | 1,04,000 | 1,00,000 | 30,000 | 1,00,000 | 20,000 |
| Case 3 | C | 80% | 56,000 | 50,000 | 20,000 | 50,000 | 20,000 |
| Case 4 | D | 100% | 1,00,000 | 50,000 | 40,000 | 50,000 | 55,000 |

*(MTP-March 2019) (5 Marks)*

**Answer:**

The balance in the Profit & Loss Account on the date of acquisition (1.1.2018) is Capital profit, as such the balance of Consolidated Profit & Loss Account shall be equal to Holding Co.'s profit.

On 31.12.2018 in each case the following amount shall be added or deducted from the balance of holding Co.'s Profit & Loss account.

| | % Share holding<br>[K] | P & L as on 31.12.2018<br>[L] | P & L as on consolidation date<br>[M] | P & L post acquisition<br>[N] = [M]-[L] | Amount to be added/ (deducted) from holding's P & L<br>[O] = [K] x [N] |
|---|---|---|---|---|---|
| 1 | 90% | 50,000 | 70,000 | 20,000 | 18,000 |
| 2 | 85% | 30,000 | 20,000 | (10,000) | (8,500) |
| 3 | 80% | 20,000 | 20,000 | Nil | Nil |
| 4 | 100% | 40,000 | 55,000 | 15,000 | 15,000 |

## Question 55

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st January, 2016 for ₹2,80,000. The issued capital of ABC Ltd., on 1st January, 2016 was ₹2,00,000 and the balance in the Profit & Loss Account was ₹1,20,000.

During the year ended 31st December, 2016, ABC Ltd. earned a profit of ₹40,000 and at year end, declared and paid a dividend of ₹60,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd.

What is the amount of minority interest as on 1st January, 2016 and 31st December, 2016?

(*MTP-April 2019*) (*5 Marks*)

**Answer:**

Total dividend paid = ₹60,000

Out of post-acquisition profit = ₹40,000

Out of pre-acquisition profit = ₹20,000

Hence, 2/3rd of dividend received by XYZ will be credited to P & L and 1/3rd will be credited to Investment.

XYZ Ltd.'s share of dividend = ₹60,000 X 80% = ₹48,000

**In the books of XYZ Ltd.**

| | | ₹ | ₹ |
|---|---|---|---|
| Bank A/c | Dr. | 48,000 | |
| To Profit & Loss A/c | | | 32,000 |
| To Investments in ABC Ltd. | | | 16,000 |
| (Dividend received from ABC Ltd. 1/3 credited to investment A/c being out of capital profits - as explained above) | | | |
| *Goodwill on Consolidation:* | | | ₹ |
| Cost of shares less dividend out of capital profits | | | 2,64,000 |
| Less: Face value of capital i.e.80% of capital | | 1,60,000 | |
| | | 80,000 | 2,40,000 |
| Add: Share of capital profits [1,20,000-20,000 (dividend portion out of pre-acquisition profits)] × 80% | | | 24,000 |
| Goodwill | | | |
| Minority interest on: | | | 64,000 |
| 1st January, 2016: 20% of ₹3,20,000 [2,00,000 + 1,20,000] | | | |
| 31st December, 2016: 20% of ₹3,00,000 [2,00,000 + 1,20,000 + 40,000-60,000] | | | 60,000 |

## Question 56

The following summarised Balance Sheets of H Ltd. and its subsidiary S Ltd. were prepared as on 31st March, 2017:

| | **H Ltd. (₹)** | **S Ltd. (₹)** |
|---|---|---|
| **Equity and Liabilities** | | |
| Shareholders' Funds | | |
| Equity Share Capita! (fully paid up shares of ₹10 each) | 12,00,000 | 2,00,000 |
| **Reserves and Surplus** | | |
| General Reserve | 4,35,000 | 1,55,000 |
| Profit and Loss Account | 2,80,000 | 65,000 |
| **Current Liabilities** | | |
| Trade Payables | 3,22,000 | 1,23,000 |
| Total | 22,37,000 | 5,43,000 |

| | **H Ltd. (₹)** | **S Ltd. (₹)** |
|---|---|---|
| **Assets** | | |
| **Non-Current Assets** | | |
| ***Fixed Assets*** | | |
| Machinery | 6,40,000 | 1,80,000 |
| Furniture | 3,75,000 | 34,000 |
| ***Non-Current Investments*** | | |
| Shares in S Ltd. -16,000 shares @ ₹20 each | 3,20,000 | - |
| ***Current Assets*** | | |
| Inventories | 2,68,000 | 62,000 |
| Trade Receivables | 4,70,000 | 2,35,000 |
| Cash and Bank | 1,64,000 | 32,000 |
| Total | 22,37,000 | 5,43,000 |

H Ltd. acquired the 80% shares of S Ltd. on 1st April, 2016. On the date of acquisition, General Reserve and Profit Loss Account of S Ltd. stood at ₹50,000 and ₹30,000 respectively.

Machinery (hook value ₹2,00,000) and Furniture (book value ₹40,000) of S Ltd. were revalued at ₹3,00,000 and ₹30,000 respectively on 1st April,2016 for the purpose of fixing the price of its shares (rates of depreciation computed on the basis of useful lives: Machinery 10% and Furniture 15%). Trade Payables of H Ltd. include ₹35,000 due to S Ltd. for goods supplied since the acquisition of the shares. These goods are charged at 10% above cost. The inventories of H Ltd. includes goods costing ₹55,000 purchased from S Ltd.

You are required to prepare the Consolidated Balance Sheet as at 31st March, 2017.

*(May 2018) (20 Marks)*

**Answer:**

**Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd.**
**as at 31st March, 2017**

| Particulars | Note No. | (₹) |
|---|---|---|
| **I. Equity and Liabilities** | | |
| (1) Shareholder's Funds | | |
| (a) Share Capital | | 12,00,000 |
| (1,20,000 equity shares of ₹10each) | | |
| (b) Reserves and Surplus | 1 | 8,16,200 |
| (2) Minority Interest (W.N.4) | | 99,300 |
| (3) Current Liabilities | | |
| (a) Trade Payables | 2 | 4,10,000 |
| Total | | 25,25,500 |
| **II. Assets** | | |
| (1) Non-current assets | | |
| (a) Fixed assets | | |
| (i) Tangible assets | 3 | 13,10,500 |
| (ii) Intangible assets | 4 | 24,000 |
| (b) Current assets | | |
| (i) Inventories | 5 | 3,25,000 |
| (ii) Trade Receivables | 6 | 6,70,000 |
| (iii) Cash at Bank | 7 | 1,96,000 |
| Total | | 25,25,500 |

**Notes to Accounts**

| | | | | ₹ |
|---|---|---|---|---|
| 1. | Reserves and Surplus | | | |
| | General Reserves | | 4,35,000 | |
| | Add: 80% share of S Ltd.'s post-acquisition reserves (W.N.3) | | 84,000 | 5,19,000 |
| | Profit and Loss Account | | 2,80,000 | |
| | Add: 80% share of S Ltd.'s post-acquisition profits (W.N.3) | 21,200 | | |
| | Less: Unrealised gain | (4,000) | 17,200 | 2,97,200 |
| | | | | 8,16,200 |
| 2. | Trade Payables | | | |
| | H Ltd. | | 3,22,000 | |
| | S Ltd. | | 1,23,000 | |
| | Less: Mutual transaction | | (35,000) | 4,10,000 |
| 3. | Tangible Assets | | | |
| | Machinery | | | |
| | H. Ltd. | | 6,40,000 | |
| | S Ltd. | 2,00,000 | | |
| | Add: Appreciation | 1,00,000 | | |
| | | 3,00,000 | | |
| | Less: Depreciation | (30,000) | 2,70,000 | 9,10,000 |

| | | | | ₹ |
|---|---|---|---|---|
| | Furniture | | | |
| | H. Ltd. | | 3,75,000 | |
| | S Ltd. | 40,000 | | |
| | Less: Decrease in value | (10,000) | | |
| | | 30,000 | | |
| | Less: Depreciation | (4,500) | 25,500 | 4,00,500 |
| | | | | 13,10,500 |
| 4. | Intangible assets | | | |
| | Goodwill [WN 5] | | | 24,000 |
| 5. | Inventories | | | |
| | H Ltd. | | 2,68,000 | |
| | S Ltd. | | 62,000 | 3,30,000 |
| | Less: Inventory reserve | | | (5,000) |
| | | | | 3,25,000 |
| 6. | Trade Receivables | | | |
| | H. Ltd. | | 4,70,000 | |
| | S Ltd. | | 2,35,000 | |
| | | | | 7,05,000 |
| | Less: Mutual transaction | | | (35,000) |
| | | | | 6,70,000 |
| 7. | Cash and Bank | | | |
| | H. Ltd. | | 1,64,000 | |
| | S Ltd. | | 32,000 | 1,96,000 |

**Working Notes:**

**1. Profit or loss on revaluation of assets in the books of S Ltd. and their book values as on 1.4.2016**

| | ₹ |
|---|---|
| **Machinery** | |
| Revaluation as on 1.4.2016 | 3,00,000 |
| Less: Book value as on 1.4.2016 | (2,00,000) |
| Profit on revaluation | 1,00,000 |
| **Furniture** | |
| Revaluation as on 1.4.2016 | 30,000 |
| Less: Book value as on 1.4.2016 | (40,000) |
| Loss on revaluation | (10,000) |

**2. Calculation of short/excess depreciation**

| | **Machinery** | **Furniture** |
|---|---|---|
| Upward/(Downward) Revaluation (W.N. 4) | 1,00,000 | (10,000) |
| Rate of depreciation | 10% p.a. | 15% p.a. |
| Difference [(short)/excess] | (10,000) | 1.500 |

**3. Analysis of reserves and profits of S Ltd. as on 31.03.2017**

| | **Pre-acquisition profit upto 1.4.2016** | **Post-acquisition profits (1.4.2016-31.3.2017)** | |
|---|---|---|---|
| | **(Capital profits)** | **General Reserve** | **Profit and loss account** |
| General reserve as on 31.3.2017 | 50,000 | 1,05,000 | |
| Profit and loss account as on 31.3.2017 | 30,000 | | 35,000 |
| Upward Revaluation of machinery as on 1.4.2016 | 1,00,000 | | |
| Downward Revaluation of Furniture as on 1.4.2016 | (10,000) | | |
| Short depreciation on machinery (W.N. 5) | | | (10,000) |
| Excess depreciation on furniture (W.N. 5) | | | 1,500 |
| Total | 1,70,000 | 1,05,000 | 26,500 |

**4. Minority Interest**

| | ₹ |
|---|---:|
| Paid-up value of (2,00,000 x 20%) | 40,000 |
| Add: 20% share of pre-acquisition profits and reserves | |
| [(20% of (50,000 + 30,000)] | 16,000 |
| 20% share of profit on revaluation | 18,000 |
| 20% share of post-acquisition reserves | 21,000 |
| 20% share of post-acquisition profit | 5,300 |
| | 1,00,300 |
| Less: Unrealised Profit on Inventory (55,000x 10/110)* × 20% | (1,000) |
| | 99,300 |

* considered that ₹55,000 is cost to H Ltd. Alternative solution considering it as cost to S Ltd. is also possible

**5. Cost of Control or Goodwill**

| | | |
|---|---:|---:|
| Cost of Investment | | 3,20,000 |
| Less: Paid-up value of 80% shares | 1,60,000 | |
| 80% share of pre-acquisition profits and reserves (₹64,000+ ₹72,000) | 1,36,000 | (2,96,000) |
| Cost of control or Goodwill | | 24,000 |

## Question 57

The Summarised Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017 areas follows:

| **Particulars** | **Amounts as at 31st March, 2017** | |
|---|---:|---:|
| | **X Ltd. (₹ in lakhs)** | **Y Ltd. (₹ in lakhs)** |
| **LIABILITIES** | | |
| Share Capital: | | |
| Authorised | 20,000 | 8,000 |
| Issues and subscribed: | | |
| Equity share of ₹10 each, fully paid up | 15,000 | 6,000 |
| 15% preference shares of ₹10 each, fully paid up | 4,000 | 1,000 |
| General Reserves | 2,500 | 1,450 |
| Profit & Loss Account | 2,750 | 1,250 |
| Trade payables | 1,646 | 1,027 |
| | 25,896 | 10,727 |
| **ASSETS** | | |
| Land & Building | 3,550 | 1,510 |
| Plants Machinery | 5,275 | 3,600 |
| Furniture & Fittings | 1,945 | 655 |
| Investment in Y Ltd.: | | |
| 450 Lakh Equity share in Y Ltd. purchased on 1st April, 2016 | 6,800 | |
| Inventory | 4,142 | 2,520 |
| Trade Receivables | 3,010 | 1,882 |
| Cash and Bank Balance | 1,174 | 560 |
| | 25,896 | 10,727 |

The following information is also given to you

(a) 10% dividend on Equity shares was declared by Y Ltd. on 31st March, 2016 for the year ended 31st March, 2016. X Ltd. credited the dividend received to its Profit & Loss Account.

(b) Credit Balance of Profit & Loss account of Y Ltd. as on 1st April, 2016 was ₹650 Lakhs.

(c) General Reserve of Y Ltd. stood at same ₹1,450 Lakhs as on 1st April, 2016.

(d) Y Ltd.'s Plant & machinery showed a balance of ₹4,000 Lakh on 1st April 2016. At the time of purchase of shares in Y Ltd., X Ltd. revalued Y's Ltd. Plant & Machinery upward by ₹1,000 Lakh.

(e) Included in Trade Payables of Y Ltd. are ₹50 Lakh for goods supplied by X Ltd.

(f) On 31st March, 2017, Y's ltd. inventory included goods for ₹150 lakhs which it had purchased from X Ltd. X Ltd. sold goods to Y Ltd. at cost plus 25%.

You are required to prepare a Consolidated Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017 giving working notes. (Ignoring dividend on preference shares).

(*RTP November 2018*)

**Answer:**

**Consolidated Balance Sheet of X Ltd. and its subsidiary Y Ltd. as on 31st March, 2017**

| | **Particulars** | **Note No.** | **₹ in lakhs** |
|---|---|---|---|
| **I** | **Equity and Liabilities** | | |
| **1** | **Shareholders' Funds** | | |
| | (a) Share Capital | 1 | 19,000 |
| | (b) Reserves and Surplus | 2 | 5,620 |
| **2.** | **Minority interest** | 3 | 3,400 |
| **3.** | **Current Liabilities** | | |
| | (a) Trade payables | 4 | 2,623 |
| | Total | | 30,643 |
| **II** | **Assets** | | |
| **1** | **Non Current Assets** | | |
| | Fixed Assets | | |
| | (i) Tangible Assets | 5 | 17,435 |
| **2** | **Current Assets** | | |
| | (a) Inventories | 6 | 6,632 |
| | (b) Trade Receivables | 7 | 4,842 |
| | (c) Cash and Cash equivalents | 8 | 1,734 |
| | | | 30,643 |

**Notes to Accounts**

| | | | ₹ in lakhs |
|---|---|---|---|
| 1. | Share Capital | | |
| | Issued, Subscribed and Paid up (1,500 lakh Equity Shares of ₹10 each fully paid up) | | 15,000 |
| | 400 lakh Preference Shares of ₹10 each fully paid up | | 4,000 |
| | | | 19,000 |
| 2. | Reserves and Surplus | | |
| | Credit Balance of Profit & Loss Account | 2,750 | |
| | Less: Capital Receipt wrongly credited (Dividend @ 10% on ₹4500 Lakh Equity Shares) | 450 | |
| | | 2,300 | |
| | Add: Share in Y Ltd. Revenue Profit (Working Note i) | 825 | |
| | | 3,125 | |
| | Less: Unrealised Profit (Working Note iv) | 30 | 3,095 |
| | Capital Reserve (Working Note iii) | 25 | |
| | General Reserve | 2,500 | 2,525 |
| | | | 5,620 |
| **3.** | **Minority interest** | | |
| | 100 Lakh Preference Shares of ₹10 fully paid up | 1,000 | |
| | 150 Lakh Equity Shares of ₹10 each fully paid up | 1,500 | 2,500 |
| | Share in Revenue Profits (Working Note i) | 275 | |
| | Share in Capital Profit (working Note ii) | 625 | 900 |
| | | | 3,400 |
| **4.** | **Trade payables** | | |
| | X Ltd. | 1,646 | |
| | Y Ltd. | 1,027 | |
| | | 2,673 | |
| | Less: Mutual owing | 50 | 2,623 |

| | | | ₹ in lakhs |
|---|---|---|---|
| **5.** | **Tangible Assets** | | |
| | Land & Building | | |
| | X Ltd. | 3,550 | |
| | Y Ltd | 1,510 | 5,060 |
| | Plants Machinery | | |
| | X Ltd. | 5,275 | |
| | Y Ltd (Working note v) | 4,500 | 9,775 |
| | Furniture & Fixtures | | |
| | X Ltd. | 1,945 | |
| | Y Ltd | 655 | 2,600 |
| | | | 17,435 |
| **6.** | **Inventories** | | |
| | X Ltd. | 4,142 | |
| | Y Ltd | 2,520 | |
| | | 6,662 | |
| | Less: Unrealized Profit | 1301 | 6,632 |
| **7.** | **Trade Receivables** | | |
| | X Ltd. | 3,010 | |
| | Y Ltd | 1,882 | |
| | | 4,892 | |
| | Less: Mutual Owing | 50 | 4,842 |
| **8.** | **Cash & cash Equivalents** | | |
| | X Ltd. | 1,174 | |
| | Y Ltd | 560 | 1,734 |

**Working Notes**

**(i) Calculation of Revenue Profits**

**Y's Ltd Profit & Loss Account**

| | ₹ in lakh | | ₹ in lakh |
|---|---|---|---|
| To Equity Dividend | | By Balance b/d | 650 |
| 10% of 6,000 lakh | 600 | By Net profit for the year (Bal Fig.) | 1,200 |
| To balance c/d | 1,250 | | |
| | 1,850 | | 1,850 |

Depreciation provided on Plant & Machinery

| | |
|---|---|
| Balance as on 1st April, 2016 | 4,000 |
| Less Balance as 31st March 2017 | 3,600 |
| | 400 |
| Hence rate of Depreciation = 400/4000 × 100 | 10% |
| Net Profit for the year ended 31st March 2017 | 1,200 |
| Less: Additional Depreciation | 100 |
| Revenue Profit | 1,100 |
| X Ltd's share- 1100 × 450/600 | 825 |
| Y Ltd's share = 1100 × 150/600 | 275 |

**(ii) Calculation of Capital Profits**

| | |
|---|---|
| Profit & Loss Balance as on 1st April, 2016 | 650 |
| Less: Dividend Paid | 600 |
| | 50 |
| Add: General Reserve as on 1st April, 2016 | 1,450 |
| Add: Profit on Revaluation of Plant & machinery | 1,000 |
| Capital Profit | 2,500 |
| X Ltd's Share in Capital Profit = 2,500 × 450/600 | 1,875 |
| Y Ltd's Share in Capital Profit = 2,500 × 150/600 | 625 |

**(iii) Calculation of Capital Reserve**

| | |
|---|---|
| Paid up value of 450 Lakh equity shares | 4,500 |
| Add: Share in Capital Profits | 1,875 |
| | 6,375 |
| Amount Paid to acquire the 450 Lakh Equity Shares | 6,800 |
| Less: Dividend received out of Pre acquisition profits | 450 |
| | 6,350 |
| Capital Reserve = 6,375 - 6,350 | 25 |

**(iv) Unrealised Profit**

₹150 Lakh × 25/125* = 30 lakh

**(v) Plant & Machinery of Y Ltd.**

| | | |
|---|---|---|
| Balance as on 31st March, 2017 | | 3,600 |
| Add: Addition due to revaluation | 1,000 | |
| Less: Depreciation on additional Value of Plant & Machinery @ 10 % | 100 | 900 |
| | | 4,500 |

* ₹150 lakh considered as cost to Y Ltd.

## Question 58

Consider the following summarized balance sheets of subsidiary Neel Ltd.:

| | 2015 ₹ | 2016 ₹ | | 2015 ₹ | 2016 ₹ |
|---|---|---|---|---|---|
| Share-Capital Issued & subscribed 2,500 equity shares of ₹100 each Reserves & Surplus | 2,50,000 | 2,50,000 | Fixed Assets Cost<br>Less: Accumulated depreciation | 1,60,000<br>(24,000) | 1,60,000<br>(48,000) |
| | | | | **1,36,000** | **1,12,000** |
| Revenue reserves | 1,43,000 | 3,57,000 | Investments at cost | | |
| Current Liabilities & Provisions: | | | Current Assets: | — | 2,00,000 |
| Trade Payables | 2,45,000 | 2,47,000 | Inventory | 2,98,500 | 3,71,000 |
| Bank overdraft | — | 85,000 | Trade Receivables | 2,97,000 | 4,45,500 |
| Provision for taxation | 1,55,000 | 2,15,000 | Prepaid Expenses | 36,000 | 24,000 |
| | | | Cash at Bank | 25,500 | 1,500 |
| | **7,93,000** | **11,54,000** | | **7,93,000** | **11,54,000** |

Also consider the following information:

(i) Neel Ltd. is a subsidiary of Sky Ltd. Both the companies follow calendar year as the accounting year.

(ii) Sky Ltd. values inventory on LIFO basis while Neel Ltd. used FIFO basis. To bring Neel Ltd.'s values in line with those of Sky Ltd. its value of inventory is required to be reduced by ₹6,000 at the end of 2015 and ₹17,000 at the end of 2016.

(iii) Neel Ltd. deducts 1% from Trade Receivables as a general provision against doubtful debts.

(iv) Prepaid expenses in Neel Ltd. include advertising expenditure carried forward of ₹30,000 in 2015 and ₹15,000 in 2016, being part of initial advertising expenditure of ₹45,000 in 2015 which is being written off over three years. Similar amount of advertising expenditure of Sky Ltd. has been fully written off in 2015.

You are required to restate the balance sheet of Neel Ltd. as on 31st December, 2016 after considering the above information, for the purpose of consolidation. Make the necessary restatement which is necessary to make the accounting policies adopted by Sky Ltd. and Neel Ltd. uniform.

(*MTP-April 2019*) (*12 Marks*)

**Answer*:***

**(a) Adjusted revenue reserves of Neel Ltd.**

| | ₹ | ₹ |
|---|---|---|
| Revenue reserves as given | | 3,57,000 |
| *Add*: Provision for doubtful debts [4,45,500/99 × 1] | | 4,500 |
| | | **3,61,500** |
| *Less*: Reduction in value of Inventory | 17,000 | |
| Advertising expenditure to be written off | 15,000 | (32,000) |
| Adjusted revenue reserve | | 3,29,500 |

*Note*: Since Neel Ltd. follows FIFO basis, it is assumed that opening inventory has been sold out during the year 2015. Therefore, reduction in inventory would have been taken care of by sale value. Hence no adjustment has been made for the same.

**Restated Balance Sheet of Neel Ltd.**
**as at 31st December, 2016**

| | Particulars | Note No. | (₹) |
|---|---|---|---|
| **I.** | **Equity and Liabilities** | | |
| | **(1) Shareholder's Funds** | | 2,50,000 |
| | (a) Share Capital | 1 | 3,29,500 |
| | (b) Reserves and Surplus | | |
| | **(2) Current Liabilities** | | |
| | (a) Short term borrowings | 2 | 85,000 |
| | (b) Trade Payables | | 2,47,000 |
| | (c) Short-term provision | 3 | 2,15,000 |
| | **Total** | | **11,26,500** |
| **II.** | **Assets** | | |
| | **(1) Non-current assets** | | |
| | (a) Fixed assets | | |
| | Tangible assets | 4 | 1,12,000 |
| | (b) Non-current Investment | | 2,00,000 |
| | **(2) Current assets** | | |
| | (a) Inventories | | 3,54,000 |
| | (b) Trade Receivables | | 4,50,000 |
| | (c) Cash & Cash Equivalents | | 1,500 |
| | (d) Other current assets | | 9,000 |
| | **Total** | | **11,26,500** |

**Notes to Accounts**

| | | | ₹ |
|---|---|---|---|
| **1.** | **Reserves and Surplus** | | |
| | Revenue Reserve (refer computation of adjusted revenue reserves of Neel Ltd) | | 3,29,500 |
| **2.** | **Short term borrowings** | | 85,000 |
| | Bank overdraft | | |
| **3.** | **Short-term provision** | | 2,15,000 |
| | Provision for taxation | | |
| **4.** | **Tangible Assets** | | |
| | Cost | 1,60,000 | |
| | *Less*: Depreciation to date | (48,000) | 1,12,000 |
| **5.** | **Other current assets** | | |
| | Prepaid expenses (After adjusting advertising expenditure to be written off each year) | | 9,000 |

## Question 59

The following summarised Balance Sheets of H Ltd. and its subsidiary S Ltd. were prepared as on 31st March, 2019:

| | H Ltd. (₹) | S Ltd. (₹) |
|---|---|---|
| **Equity and Liabilities** | | |
| **Shareholders' Funds** | | |
| Equity Share Capital (fully paid up shares of ₹10 each) | 12,00,000 | 2,00,000 |
| **Reserves and Surplus** | | |
| General Reserve | 4,35,000 | 1,55,000 |
| Profit and Loss Account | 2,80,000 | 65,000 |
| **Current Liabilities** | | |
| Trade Payables | 3,25,000 | 1,25,000 |
| Total | 22,40,000 | 5,45,000 |

| | H Ltd. (₹) | S Ltd. (₹) |
|---|---|---|
| **Assets** | | |
| **Non-Current Assets** | | |
| Property, Plant and Equipment | | |
| Machinery | 6,40,000 | 1,80,000 |
| Furniture | 3,75,000 | 34,000 |
| **Non-Current Investments** | | |
| Shares in S Ltd. - 16,000 shares @ ₹20 each | 3,20,000 | - |
| **Current Assets** | | |
| Inventories | 2,68,000 | 62,000 |
| Trade Receivables | 4,73,000 | 2,37,000 |
| Cash and Bank | 1,64,000 | 32,000 |
| Total | 22,40,000 | 5,45,000 |

H Ltd. acquired the 80% shares of S Ltd. on 1st April, 2018. On the date of acquisition, General Reserve and Profit Loss Account of S Ltd. stood at ₹50,000 and ₹30,000 respectively.

Machinery (book value ₹2,00,000) and Furniture (book value ₹40,000) of S Ltd. were revalued at ₹3,00,000 and ₹30,000 respectively on 1st April,2018 for the purpose of fixing the price of its shares (rates of depreciation computed on the basis of useful lives: Machinery 10% and Furniture 15%). Trade Payables of H Ltd. include ₹40,000 due to S Ltd. for goods supplied since the acquisition of the shares. These goods are charged at 10% above cost. The inventories of H Ltd. Includes goods costing ₹55,000 (cost to H Ltd.) purchased from S Ltd.

You are required to prepare the Consolidated Balance Sheet of H Ltd. with its subsidiary S Ltd. as at 31st March, 2019.

(*RTP November 2019*)

**Answer:**

**Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2019**

| *Particulars* | *Note No.* | *(₹)* |
|---|---|---|
| I. Equity and Liabilities | | |
| (1) Shareholder's Funds | | |
| (a) Share Capital (1,20,000 equity shares of ₹10 each) | | 12,00,000 |
| (b) Reserves and Surplus | 1 | 8,16,200 |
| (2) Minority Interest (W.N.4) | | 99,300 |
| (3) Current Liabilities | | |
| (a) Trade Payables | 2 | 4,10,000 |
| Total | | 25,25,500 |
| II. Assets | | |
| (1) Non-current assets | | |
| (a) Property, Plant and Equipment | | |
| (i) Tangible assets | 3 | 13,10,500 |
| (ii) Intangible assets | 4 | 24,000 |
| (b) Current assets | | |
| (i) Inventories | 5 | 3,25,000 |
| (ii) Trade Receivables | 6 | 6,70,000 |
| (iii) Cash at Bank | 7 | 1,96,000 |
| Total | | 25,25,500 |

**Notes to Accounts**

| | | | | ₹ |
|---|---|---|---|---|
| 1. | Reserves and Surplus | | | |
| | General Reserves | | 4,35,000 | |
| | *Add:* 80% share of S Ltd.'s post- acquisition reserves (W.N.3) | | 84,000 | 5,19,000 |
| | Profit and Loss Account | | 2,80,000 | |
| | *Add:* 80% share of S Ltd.'s post- acquisition profits (W.N.3) | 21,200 | | |
| | *Less:* Unrealised gain | (4,000) | 17,200 | 2,97,200 |
| | | | | 8,16,200 |
| 2. | Trade Payables | | | |
| | H Ltd. | | 3,25,000 | |
| | S Ltd. | | 1,25,000 | |
| | *Less:* Mutual transaction | | (40,000) | 4,10,000 |
| 3. | Tangible Assets | | | |
| | Machinery | | | |
| | H Ltd. | | 6,40,000 | |

| | | | | ₹ |
|---|---|---|---|---|
| | S Ltd. | 2,00,000 | | |
| | *Add:* Appreciation | 1,00,000 | | |
| | | 3,00,000 | | |
| | *Less:* Depreciation | (30,000) | 2,70,000 | 9,10,000 |
| | Furniture | | | |
| | H. Ltd. | | 3,75,000 | |
| | S Ltd. | 40,000 | | |
| | *Less:* Decrease in value | (10,000) | | |
| | | 30,000 | | |
| | *Less*: Depreciation | (4,500) | 25,500 | 4,00,500 |
| | | | | 13,10,500 |
| 4. | Intangible assets | | | |
| | Goodwill [WN 5] | | | 24,000 |
| 5. | Inventories | | | |
| | H Ltd. | | 2,68,000 | |
| | S Ltd. | | 62,000 | 3,30,000 |
| | *Less:* Inventory reserve | | | (5,000) |
| | | | | 3,25,000 |
| 6. | Trade Receivables | | | |
| | H Ltd. | | 4,73,000 | |
| | S Ltd. | | 2,37,000 | 7,10,000 |
| | *Less:* Mutual transaction | | | (40,000) |
| | | | | 6,70,000 |
| 7. | Cash and Bank | | | |
| | H Ltd. | | 1,64,000 | |
| | S Ltd. | | 32,000 | 1,96,000 |

**Working Notes:**

**1. Profit or loss on revaluation of assets in the books of S Ltd. and their book values as on 1.4.2018**

| | ₹ |
|---|---|
| ***Machinery*** | |
| Revaluation as on 1.4.2018 | 3,00,000 |
| Less: Book value as on 1.4.2018 | (2,00,000) |
| Profit on revaluation | 1,00,000 |
| ***Furniture*** | |
| Revaluation as on 1.4.2018 | 30,000 |
| Less: Book value as on 1.4.2018 | (40,000) |
| Loss on revaluation | (10,000) |

**2. Calculation of short/excess depreciation**

| | ***Machinery*** | ***Furniture*** |
|---|---|---|
| Upward/(Downward) Revaluation (W.N. 4) | 1,00,000 | (10,000) |
| Rate of depreciation | 10% p.a. | 15% p.a. |
| Difference [(short)/excess] | (10,000) | 1,500 |

**3. Analysis of reserves and profits of S Ltd. as on 31.03.2019**

| | ***Pre-acquisition profit upto 1.4.2018*** | ***Post-acquisition profits (1.4.2018 – 31.3.2019)*** | |
|---|---|---|---|
| | ***(Capital profits)*** | ***General Reserve*** | ***Profit and loss account*** |
| General reserve as on 31.3.2019 | 50,000 | 1,05,000 | |
| Profit and loss account as on 31.3.2019 | 30,000 | | 35,000 |
| Upward Revaluation of machinery as on 1.4.2018 | 1,00,000 | | |
| Downward Revaluation of Furniture as on 1.4.2018 | (10,000) | | |
| Short depreciation on machinery (W.N. 5) | | | (10,000) |
| Excess depreciation on furniture (W.N. 5) | | | 1,500 |
| Total | 1,70,000 | 1,05,000 | 26,500 |

**4. Minority Interest**

| | ₹ |
|---|---|
| Paid-up value of (2,00,000 x 20%) | 40,000 |
| *Add:* 20% share of pre-acquisition profits and reserves [(20% of (50,000 + 30,000)] | 16,000 |
| 20% share of profit on revaluation | 18,000 |
| 20% share of post-acquisition reserves | 21,000 |
| 20% share of post-acquisition profit | 5,300 |
| | 1,00,300 |
| Less: Unrealised Profit on Inventory (55,000 x 10/110) x 20% | (1,000) |
| | 99,300 |

**5. Cost of Control or Goodwill**

| | | |
|---|---|---|
| Cost of Investment | | 3,20,000 |
| Less: Paid-up value of 80% shares | 1,60,000 | |
| 80% share of pre-acquisition profits and reserves | | |
| (₹64,000 + ₹72,000) | 1,36,000 | (2,96,000) |
| Cost of control or Goodwill | | 24,000 |

## Question 60

Consider the following summarized Balance Sheets of subsidiary MNT Ltd.:

| **Liabilities** | **2017-18 Amount in ₹** | **2018-19 Amount in ₹** |
|---|---|---|
| **Share Capital** | | |
| Issued and subscribed 7500 Equity | | |
| Shares of ₹100 each | 7,50,000 | 7,50,000 |
| **Reserve and Surplus** | | |
| Revenue Reserve | 2,14,000 | 5,05,000 |
| Securities Premium | 72,000 | 2,07,000 |
| **Current Liabilities and Provisions** | | |
| Trade Payables | 2,90,000 | 2,46,000 |
| Bank Overdraft | — | 1,70,000 |
| Provision for Taxation | 2,62,000 | 4,30,000 |
| | 15,88,000 | 23,08,000 |
| **Assets** | | |
| Fixed Assets (Cost) | 9,20,000 | 9,20,000 |
| Less: Accumulated Depreciation | (1,70,000) | (2,82,500) |
| | 7,50,000 | 6,37,500 |
| **Investment at Cost** | — | 5,30,000 |
| **Current Assets** | | |
| Inventory | 4,12,300 | 6,90,000 |
| Trade Receivable | 2,95,000 | 3,43,000 |
| Prepaid expenses | 78,000 | 65,000 |
| Cash at Bank | 52,700 | 42,500 |
| | 15,88,000 | 23,08,000 |

**Other Information:**

(1) MNT Ltd. is a subsidiary of LTC Ltd.

(2) LTC Ltd. values inventory on FIFO basis, while MNT Ltd. used LIFO basis. To bring MNT Ltd.'s inventories values in line with those of LTC Ltd., its value of inventory is required to be reduced by ₹5,000 at the end of 2017-2018 and increased by ₹12,000 at the end of 2018-2019. (Inventory of 2017-18 has been sold out during the year 2018-19)

(3) MNT Ltd. deducts 2% from Trade Receivables as a general provision against doubtful debts.

(4) Prepaid expenses in MNT Ltd. include Sales Promotion expenditure carried forward of ₹25,000 in 2017-18 and ₹12,500 in 2018-19 being part of initial Sales Promotion expenditure of ₹37,500 in 2017-18, which is being written off over three years. Similar nature of Sales Promotion expenditure of LTC Ltd. has been fully written off in 2017-18.

Restate the balance sheet of MNT Ltd. as on 31st March, 2019 after considering the above information for the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by LTC Ltd. and MNT Ltd. uniform. (*November 2019, New Course, 10 Marks*)

**Answer**

**Restated Balance Sheet of MNT Ltd. as at 31st December, 2019**

| Particulars | Note No. | (₹) |
|---|---|---|
| **I. Equity and Liabilities** | | |
| **(1) Shareholder's Funds** | | |
| (a) Share Capital | | 7,50,000 |
| (b) Reserves and Surplus | 1 | 7,18,500 |
| **(2) Current Liabilities** | | |
| (a) Short term borrowings | 2 | 1,70,000 |
| (b) Trade Payables | | 2,46,000 |
| (c) Short-term provision | 3 | 4,30,000 |
| Total | | 23,14,500 |
| **II. Assets** | | |
| **(1) Non-current assets** | | |
| (a) Property, Plant & Equipment | 4 | 6,37,500 |
| (b) Non-current Investment | | 5,30,000 |
| **(2) Current assets** | | |
| (a) Inventories (6,90,000 +12,000) | 5 | 7,02,000 |
| (b) Trade Receivables | | 3,50,000 |
| (c) Cash & Cash Equivalents | | |
| (d) Other current assets | 6 | 42,500 |
| | | 52,500 |
| Total | | 23,14,500 |

**Notes to Accounts**

| | | | ₹ |
|---|---|---|---|
| 1. | **Reserves and Surplus** | | |
| | Revenue Reserve (refer W.N.) | 5,11,500 | |
| | Securities Premium | 2,07,000 | 7,18,500 |
| 2. | **Short term borrowings** | | |
| | Bank overdraft | | 1,70,000 |
| 3. | **Short-term provision** | | |
| | Provision for taxation | | 4,30,000 |
| 4. | **Property, Plant and Equipment** | | |
| | Cost | 9,20,000 | |
| | *Less*: Depreciation to date | (2,82,500) | 6,37,500 |
| 5. | **Inventories** | 6,90,000 | |
| | Increase in value as per FIFO | 12,000 | 7,02,000 |
| 6. | **Other current assets** | | |
| | Prepaid expenses (After adjusting sales promotion expenses to be written off each year) (65,000 -12,500) | | 52,500 |

**Working Note:**

**Adjusted revenue reserves of MNT Ltd.:**

| | ₹ | ₹ |
|---|---|---|
| Revenue reserves as given | | 5,05,000 |
| *Add:* Provision for doubtful debts [3,43,000 X 2/98) | 7,000 | |
| *Add:* Increase in value of inventory | 12,000 | 19,000 |
| | | 5,24,000 |
| *Less:* Sales Promotion expenditure to be written off | | (12,500) |
| Adjusted revenue reserve | | 5,11,500 |

## Question 61

From the following summarized balance sheets of Kedar Ltd. and its subsidiary Vijay Ltd. drawn up at 31st March, 2019, prepare a consolidated balance sheet as at that date, having regard to the following:

(i) Reserves and Profit and Loss Account of Vijay Ltd. stood at ₹ 62,500 and ₹ 37,500 respectively on the date of acquisition of its 80% shares by Kedar Ltd. on 1st April, 2018.

(ii) Machinery (Book-value ₹ 2,50,000) and Furniture (Book value ₹ 50,000) of Vijay Ltd. were revalued at ₹ 3,75,000 and ₹ 37,500 respectively on 1st April, 2018 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.]

**Summarised Balance Sheet of Kedar Ltd. and Vijay Ltd. as on 31st March, 2019**

| Liabilities | Kedar Ltd. | Vijay Ltd. | Assets | Kedar Ltd. | Vijay Ltd. |
|---|---|---|---|---|---|
| Equity and Liabilities | ₹ | ₹ | Non-current assets | ₹ | ₹ |
| Shareholders' funds | | | Fixed assets | | |
| Share Capital | | | Machinery | 7,50,000 | 2,25,000 |
| Shares of ₹ 100 each | 15,00,000 | 2,50,000 | Furniture | 3,75,000 | 42,500 |
| Reserves | 5,00,000 | 1,87,500 | Other non-current assets | 11,00,000 | 3,75,000 |
| Profit and Loss | | | Non-current Investments | | |
| Account | 2,50,000 | 62,500 | Shares in Vijay Ltd.: | | |
| Trade Payables | 3,75,000 | 1,42,500 | 2,000 shares at ₹ 200 each | 4,00,000 | — |
| | 26,25,000 | 6,42,500 | | 26,25,000 | 6,42,500 |

(*May 2020*)

**Answer**

**Consolidated Balance Sheet of Kedar Ltd. and its Subsidiary Vijay Ltd. as at 31st March, 2019**

| Particulars | Note No. | (₹) |
|---|---|---|
| **I. Equity and Liabilities** | | |
| **(1) Shareholder's Funds** | | |
| (a) Share Capital | | 15,00,000 |
| (b) Reserves and Surplus | 1 | 8,61,500 |
| **(2) Minority Interest** (W.N.5) | | 1,20,375 |
| **(3) Current Liabilities** | | |
| (a) Trade Payables | 2 | 5,17,500 |
| **Total** | | 29,99,375 |
| **II. Assets** | | |
| **(1) Non-current assets** | | |
| (a) (i) Property, Plant & Equipment | 3 | 14,94,375 |
| (ii) Intangible assets | 4 | 30,000 |
| (b) Other non- current assets | 5 | 14,75,000 |
| **Total** | | 29,99,375 |

**Notes to Accounts**

| | | | | ₹ |
|---|---|---|---|---|
| **1.** | **Reserves and Surplus** | | | |
| | Reserves | | 5,00,000 | |
| | *Add:* 4/5th share of Vijay Ltd.'s post- acquisition reserves (W.N.3) | | 1,00,000 | 6,00,000 |
| | Profit and Loss Account | | 2,50,000 | |
| | *Add:* 4/5th share of Vijay Ltd.'s post- acquisition profits (W.N.4) | | 11,500 | 2,61,500 |
| | | | | 8,61,500 |
| **2.** | **Trade Payables** | | | |
| | Kedar Ltd. | | 3,75,000 | |
| | Vijay Ltd. | | 1,42,500 | 5,17,500 |
| **3.** | **Property, Plant & Equipment** | | | |
| | Machinery | | | |
| | Kedar Ltd. | | 7,50,000 | |

| | | | | ₹ |
|---|---|---|---|---|
| | Vijay Ltd. | 2,50,000 | | |
| | Add: Appreciation | 1,25,000 | | |
| | | 3,75,000 | | |
| | Less: Depreciation | (37,500) | 3,37,500 | |
| | Furniture | - | | |
| | Kedar Ltd. | - | 3,75,000 | |
| | Vijay Ltd. | 50,000 | | |
| | Less: Decrease in value | (12,500) | | |
| | | 37,500 | | |
| | *Less*: Depreciation | (5,625) | 31,875 | 14,94,375 |
| **4.** | **Intangible assets** | | | |
| | Goodwill [WN 6] | | | 30,000 |
| **5.** | **Other non-current assets** | | | |
| | Kedar Ltd. | | 11,00,000 | |
| | Vijay Ltd. | | 3,75,000 | 14,75,000 |

**Working Notes:**

| | | ₹ |
|---|---|---|
| **1.** | **Pre-acquisition profits and reserves of Vijay Ltd.** | |
| | Reserves | 62,500 |
| | Profit and Loss Account | 37,500 |
| | | 1,00,000 |
| | Kedar Ltd.'s = 4/5 × 1,00,000 | 80,000 |
| | Minority Interest = 1/5 × 1,00,000 | 20,000 |
| **2.** | **Profit on revaluation of assets of Vijay Ltd.** | - |
| | Profit on Machinery ₹ (3,75,000 – 2,50,000) | 1,25,000 |
| | *Less*: Loss on Furniture ₹ (50,000 – 37,500) | 12,500 |
| | Net Profit on revaluation | 1,12,500 |
| | Kedar Ltd.'s share 4/5 × 1,12,500 | 90,000 |
| | Minority Interest 1/5 × 1,12,500 | 22,500 |
| **3.** | **Post-acquisition reserves of Vijay Ltd.** | - |
| | Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 1,87,500 – 62,500) | 1,25,000 |
| | Kedar Ltd.'s share 4/5 × 1,25,000 | 1,00,000 |
| | Minority interest 1/5 × 25,000 | 25,000 |
| **4.** | **Post -acquisition profits of Vijay Ltd.** | - |
| | Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = ₹ 62,500 – 37,500) | 25,000 |
| | *Add:* Excess depreciation charged on furniture @ 15% | - |
| | on ₹ 12,500 i.e. (50,000 – 37,500) | 1,875 |
| | | 26,875 |
| | *Less*: Under depreciation on machinery @ 10% | - |
| | on ₹ 1,25,000 i.e. (3,75,000 – 2,50,000) | (12,500) |
| | Adjusted post-acquisition profits | 14,375 |
| | Kedar Ltd.'s share 4/5 × 14,375 | 11,500 |
| | Minority Interest 1/5 × 14,375 | 2,875 |
| **5.** | **Minority Interest** | - |
| | Paid-up value of (2,500 – 2,000) = 500 shares | - |
| | held by outsiders i.e. 500 × ₹ 100 | 50,000 |
| | *Add:* 1/5th share of pre-acquisition profits and reserves | 20,000 |
| | 1/5th share of profit on revaluation | 22,500 |
| | 1/5th share of post-acquisition reserves | 25,000 |
| | 1/5th share of post-acquisition profit | 2,875 |
| **6.** | **Cost of Control or Goodwill** | 1,20,375 |
| | Paid-up value of 2,000 shares held by Kedar Ltd. i.e. 2,000 × ₹ 100 | 2,00,000 |
| | *Add:* 4/5th share of pre-acquisition profits and reserves | 80,000 |
| | 4/5th share of profit on the revaluation | 90,000 |
| | Intrinsic value of shares on the date of acquisition | 3,70,000 |
| | Price paid by Kedar Ltd. for 2,000 shares | 4,00,000 |
| | *Less:* Intrinsic value of the shares | (3,70,000) |
| | Cost of control or Goodwill | 30,000 |

## Question 62

Given below are the Profit & Loss Accounts of Hello Ltd. and its subsidiary Sun Ltd. for the year ended 31st March, 2017:

| | Hello Ltd. (₹ in lacs) | Sun Ltd. (₹ in lacs) |
|---|---|---|
| Incomes: | | |
| Sales and other income | 10,000 | 2,000 |
| Increase in Inventory | 2,000 | 400 |
| | 12,000 | 2,400 |
| Expenses: | | |
| Raw material consumed | 1,600 | 400 |
| Wages and Salaries | 1,600 | 300 |
| Production expenses | 400 | 200 |
| Administrative Expenses | 400 | 200 |
| Selling and Distribution Expenses | 400 | 100 |
| Interest | 200 | 100 |
| Depreciation | 200 | 100 |
| | 4,800 | 1,400 |
| Profit before tax | 7,200 | 1,000 |
| Provision for tax | 2,400 | 400 |
| Profit after tax | 4,800 | 600 |
| Dividend paid | 2,400 | 300 |
| Balance of Profit | 2,400 | 300 |

Other Information:

Hello Ltd. sold goods to Sun Ltd. of ₹240 lacs at cost plus 20%. Inventory of Sun Ltd. includes such goods valuing ₹48 lacs. Administrative expenses of Sun Ltd. include ₹10 lacs paid to Hello Ltd. as consultancy fees. Selling and distribution expenses of Hello Ltd. include ₹20 lacs paid to Sun Ltd. as commission.

Hello Ltd. holds 80% of equity share capital of ₹2,000 lacs in Sun Ltd. prior to 2015-2016. Hello Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by Sun Ltd. for the year 2015-2016.

You are required to prepare a consolidated profit and loss account of Hello Ltd. and its subsidiary Sun Ltd. for the year ended 31st March, 2017.

(*RTP May 2018*)

**Answer:**

**Consolidated Profit & Loss Account of Hello Ltd. and its subsidiary Sun Ltd. for the year ended on 31st March, 2017**

| Particulars | Note No. | ₹ in Lacs |
|---|---|---|
| I. Revenue from operations | 1 | 11,730 |
| II. Total revenue | | 11,730 |
| III. Expenses | | |
| Cost of Material purchased/Consumed | 3 | 2,360 |
| Changes of Inventories of finished goods | 2 | (2,392) |
| Employee benefit expense | 4 | 1,900 |
| Finance cost | 6 | 300 |
| Depreciation and amortization expense | 7 | 300 |
| Other expenses | 5 | 1,070 |
| Total expenses | | 3,538 |
| IV. Profit before Tax (II - III) | | 8,192 |
| V. Tax Expenses | 8 | 2,800 |
| VI. Profit After Tax | | 5,392 |
| Profit transferred to Consolidated Balance Sheet | | |
| Profit After Tax | | 5,392 |
| Dividend paid | | |
| Hello Ltd. | 2,400 | |
| Sun Ltd. | 300 | |
| | 2,700 | |
| Less: Share of Hello Ltd. in dividend of Sun Ltd. | | |
| 80% of ₹300 lacs | (240) | (2,460) |
| Profit to be transferred to consolidated balance sheet | | 2,932 |

**Notes to Accounts**

| | | ₹ in Lacs | ₹ in Lacs |
|---|---|---|---|
| 1. | Revenue from Operations | | |
| | Sales and other income | | |
| | Hello Ltd. | 10,000 | |
| | Sun Ltd. | 2,000 | |
| | | 12,000 | |
| | Less: Inter-company Sales | (240) | |
| | Consultancy fees received by Hello Ltd. from Sun Ltd. | (10) | |
| | Commission received by Sun Ltd. from Hello Ltd. | (20) | 11,730 |
| 2. | Increase in Inventory | | |
| | Hello Ltd. | 2,000 | |
| | Sun Ltd. | 400 | |
| | | 2,400 | |
| | Less: Unrealized profits ₹48 lacs × $\frac{20}{120}$ | (8) | 2,392 |
| | | | 14,122 |
| 3. | Cost of Material purchased/consumed | | |
| | Hello Ltd. | 1,600 | |
| | Sun Ltd. | 400 | |
| | | 2,000 | |
| | Less: Purchases by Sun Ltd. from Hello Ltd. | (240) | 1,760 |
| | Direct Expenses | | |
| | Hello Ltd. | 400 | |
| | Sun Ltd. | 200 | 600 |
| | | | 2,360 |
| 4. | Employee benefits and expenses | | |
| | Wages and Salaries: | | |
| | Hello Ltd. | 1,600 | |
| | Sun Ltd. | 300 | 1,900 |
| 5. | Other Expenses | | |
| | Administrative Expenses | | |
| | Hello Ltd. | 400 | |
| | Sun Ltd. | 200 | |
| | | 600 | |
| | Less: Consultancy fees received by Hello Ltd. from Sun Ltd. | (10) | 590 |
| | Selling and Distribution Expenses: | | |
| | Hello Ltd. | 400 | |
| | Sun Ltd. | 100 | |
| | | 500 | |
| | Less: Commission received from Sun Ltd. from Hello Ltd. | (20) | 480 |
| | | | 1,070 |
| 6. | Finance Cost | | |
| | Interest: | | |
| | Hello Ltd. | 200 | |
| | Sun Ltd. | 100 | 300 |
| 7. | Depreciation and Amortization Depreciation: | | |
| | Hello Ltd. | 200 | |
| | Sun Ltd. | 100 | 300 |
| 8. | Provision for tax | | |
| | Hello Ltd. | 2,400 | |
| | Sun Ltd. | 400 | 2,800 |

**Note**: Since the amount of dividend received by Hello Ltd. for the year 2015-2016 is not given, it has not been deducted from 'sales and other income' in consolidated profit and loss account and not added to consolidated opening retained earnings (which is also not given).

## Question 63

Given below are the Profit & Loss Accounts of H Ltd. and its subsidiary Ltd. for the year ended 31st March, 2017:

| | H Ltd. (₹ in lacs) | S Ltd. (₹ in lacs) |
|---|---|---|
| Incomes: | | |
| Sales and other income | 5,000 | 1,000 |
| Increase in Inventory | 1,000 | 200 |
| | 6,000 | 1,200 |
| Expenses: | | |
| Raw material consumed | 800 | 200 |
| Wages and Salaries | 800 | 150 |
| Production expenses | 200 | 100 |
| Administrative Expenses | 200 | 100 |
| Selling and Distribution Expenses | 200 | 50 |
| Interest | 100 | 50 |
| Depreciation | 100 | 50 |
| | 2,400 | 700 |
| Profit before tax | 3,600 | 500 |
| Provision for tax | 1,200 | 200 |
| Profit after tax | 2,400 | 300 |
| Dividend paid | 1,200 | 150 |
| Balance of Profit | 1,200 | 150 |

Other Information:

H Ltd. sold goods to S Ltd. of ₹120 lacs at cost plus 20%. Inventory of S Ltd. includes such goods valuing ₹24 lacs. Administrative expenses of S Ltd. include ₹5 lacs paid to H Ltd. as consultancy fees. Selling and distribution expenses of H Ltd. include ₹10 lacs paid to S Ltd. as commission.

H Ltd. holds 80% of equity share capital of ₹1,000 lacs in S Ltd. prior to 2015-2016. H Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by S Ltd. for the year 2015-2016.

You are required to prepare a consolidated profit and loss account of H Ltd. and its subsidiary S Ltd. for the year ended on 31st March, 2017.

(*MTP March 2018*) (*12 Marks*)

**Answer:**

**Consolidated Profit & Loss Account of H Ltd. and its subsidiary S Ltd.**
**for the year ended on 31st March, 2017**

| Particulars | Note No. | ₹ in Lacs |
|---|---|---|
| I. Revenue from operations | 1 | 5,865 |
| II. Total revenue | | 5,865 |
| III. Expenses | | |
| Cost of Material purchased/Consumed | 3 | 1,180 |
| Changes of Inventories of finished goods | 2 | (1,196) |
| Employee benefit expense | 4 | 950 |
| Finance cost | 6 | 150 |
| Depreciation and amortization expense | 7 | 150 |
| Other expenses | 5 | 535 |
| Total expenses | | 1,769 |
| IV. Profit before Tax (II-III) | | 4,096 |
| V. Tax Expenses | 8 | 1,400 |
| VI. Profit After Tax | | 2,696 |
| Profit transferred to Consolidated Balance Sheet | | |
| Profit After Tax | | 2,696 |
| Dividend paid | | |
| H Ltd. | 1,200 | |
| S Ltd. | 150 | |
| | 1,350 | |
| Less: Share of H Ltd. in dividend of S Ltd. | | |
| 80% of ₹150 lacs | (120) | (1,230) |
| Profit to be transferred to consolidated balance sheet | | 1,466 |

**Notes to Accounts**

| | | ₹ in lacs | ₹ in lacs |
|---|---|---|---|
| 1. | Revenue from Operations | | |
| | Sales and other income | | |
| | H Ltd. | 5,000 | |
| | S Ltd. | 1,000 | |
| | | 6,000 | |
| | Less: Inter-company Sales | (120) | |
| | Consultancy fees received by H Ltd. from S Ltd. | (5) | |
| | Commission received by S Ltd. from H Ltd. | (10) | 5,865 |
| 2. | Increase in Inventory | | |
| | H Ltd. | 1,000 | |
| | S Ltd. | 200 | |
| | | 1,200 | |
| | Less: Unrealized profits ₹24 lacs × 20/120 | (4) | 1,196 |
| | | | 7,061 |
| 3. | Cost of Material purchased/consumed | | |
| | H Ltd. | 800 | |
| | S Ltd. | 200 | |
| | | 1,000 | |
| | Less: Purchases by S Ltd. from H Ltd. | (120) | 880 |
| | Direct Expenses | | |
| | H Ltd. | 200 | |
| | S Ltd. | 100 | 300 |
| | | | 1,180 |
| 4. | Employee benefits and expenses | | |
| | Wages and Salaries: | | |
| | H Ltd. | 800 | |
| | S Ltd. | 150 | 950 |
| 5. | Other Expenses | | |
| | Administrative Expenses | | |
| | H Ltd. | 200 | |
| | S Ltd. | 100 | |
| | | 300 | |
| | Less: Consultancy fees received by H Ltd. from S Ltd. | (5) | 295 |
| | Selling and Distribution Expenses: | | |
| | H Ltd. | 200 | |
| | S Ltd. | 50 | |
| | | 250 | |
| | Less: Commission received from S Ltd. from H Ltd. | (10) | 240 |
| | | | 535 |
| 6. | Finance Cost | | |
| | Interest: | | |
| | H Ltd. | 100 | |
| | S Ltd. | 50 | 150 |
| 7. | Depreciation and Amortisation | | |
| | Depreciation: | | |
| | H Ltd. | 100 | |
| | S Ltd. | 50 | 150 |
| 8. | Provision for tax | | |
| | H Ltd. | 1,200 | |
| | S. Ltd. | 200 | 1,400 |

## Question 64

The Profit and Loss Accounts of A Ltd. and its subsidiary B Ltd. for the year ended 31st March, 2018 are given below:

**₹ in Lakhs**

| **Incomes** | **A Ltd.** | **B Ltd.** |
|---|---|---|
| Sales and other income | 7,500 | 1,500 |
| Increase in Inventory | 1,500 | 300 |
| Total | 9,000 | 1,800 |
| **Expenses** | | |
| Raw material consumed | 1,200 | 300 |
| Wages and Salaries | 1,200 | 225 |
| Production expenses | 300 | 150 |
| Administrative expenses | 300 | 150 |
| Selling and distribution expenses | 300 | 75 |
| Interest | 150 | 75 |
| Depreciation | 150 | 11 |
| Total | 3,600 | 1,050 |
| Profit before tax | 5,400 | 750 |
| Provision for tax | 1,800 | 300 |
| Profit after tax | 3,600 | 450 |
| Dividend paid | 1,800 | 225 |
| Balance of Profit | 1,800 | 225 |

The following information is also given:

(i) A Ltd sold goods of ₹180 Lakhs to B Ltd at cost plus 25%. (1/6 of such goods were still in inventory of B Ltd at the end of the year)

(ii) Administrative expenses of B Ltd include ₹8 Lakhs paid to A Ltd as consultancy fees.

(iii) Selling and distribution expenses of A Ltd include ₹15 Lakhs paid to B Ltd as commission.

(iv) A Ltd holds 72% of the Equity Capital of B Ltd. The Equity Capital of B Ltd prior to 2016-17 is ₹1,500 lakhs.

Prepare a consolidated Profit and Loss Account for the year ended 31st March, 2018.

*(November 2018) (10 marks)*

**Answer:**

**Consolidated Profit & Loss Account of A Ltd. and its subsidiary B Ltd.**
**for the year ended on 31st March, 2018**

| **Particulars** | **Note No.** | **₹ in Lacs** |
|---|---|---|
| I. Revenue from operations | 1 | 8,797 |
| II. Total revenue | | 8,797 |
| III. Expenses | | |
| Cost of Material purchased/Consumed | 3 | 1,770 |
| Changes of Inventories of finished goods | 2 | (1,794) |
| Employee benefit expense | 4 | 1,425 |
| Finance cost | 6 | 225 |
| Depreciation and amortization expense | 7 | 225 |
| Other expenses | 5 | 802 |
| Total expenses | | 2,653 |
| IV. Profit before Tax(II-III) | | 6,144 |
| V. Tax Expenses | 8 | 2,100 |
| VI. Profit After Tax | | 4,044 |

**Notes to Accounts**

| | | **₹ in Lacs** | **₹ in Lacs** |
|---|---|---|---|
| 1. | Revenue from Operations | | |
| | Sales and other income | | |
| | A Ltd. | 7,500 | |
| | B Ltd. | 1,500 | |
| | | 9,000 | |
| | Less: Inter-company Sales | (180) | |
| | Consultancy fees received by A Ltd. from B Ltd. | (8) | |
| | Commission received by B Ltd. from A Ltd. | (15) | 8,797 |

| | | ₹ in Lacs | ₹ in Lacs |
|---|---|---|---|
| 2. | Increase in Inventory | | |
| | A Ltd. | 1,500 | |
| | B Ltd. | 300 | |
| | | 1,800 | |
| | Less: Unrealised profits ₹180x1/6x25/125 | (6) | 1,794 |
| 3. | Cost of Material purchased/consumed | | |
| | A Ltd. | 1,200 | |
| | B Ltd. | 300 | |
| | | 1,500 | |
| | Less: Purchases by B Ltd. from A Ltd. | (180) | 1,320 |
| | Direct Expenses | | |
| | A Ltd. | 300 | |
| | B Ltd. | 150 | 450 |
| | | | 1,770 |
| 4. | Employee benefits and expenses | | |
| | Wages and Salaries: | | |
| | A Ltd. | 1,200 | |
| | B Ltd. | 225 | 1,425 |
| 5. | Other Expenses | | |
| | Administrative Expenses | | |
| | A Ltd. | 300 | |
| | B Ltd. | 150 | |
| | | 450 | |
| | Less: Consultancy fees received by A Ltd. from B Ltd. | (8) | 442 |
| | Selling and Distribution Expenses: | | |
| | A Ltd. | 300 | |
| | B Ltd. | 75 | |
| | | 375 | |
| | Less: Commission received from B Ltd. from A Ltd. | (15) | 360 |
| | | | 802 |
| 6. | Finance Cost | | |
| | Interest: | | |
| | A Ltd. | 150 | |
| | B Ltd. | 75 | 225 |
| 7. | Depreciation and Amortisation | | |
| | Depreciation: | | |
| | A Ltd. | 150 | |
| | B Ltd. | 75 | 225 |
| 8. | Provision for tax | | |
| | A Ltd. | 1800 | |
| | B Ltd. | 300 | 2100 |

**Note**: it is assumed that dividend adjustment has not be done in sales & other income of A Ltd i.e. dividend received from B Ltd is not included in other income of A Ltd. Alternative answer is possible considering is otherwise.

## Question 65

(a) A Ltd holds 75% of the equity capital and voting power in B Ltd. A Ltd purchases inventories costing ₹ 150 lacs from B Ltd at a price of ₹ 200 lacs. The entire inventories remain unsold with A Ltd at the financial year end i.e. 31 March 2019. Suggest the accounting treatment for this transaction in the consolidated financial statements of A Ltd giving reference of the relevant accounting standard.

(b) From the following data, determine Minority Interest on the date of acquisition and on the date of consolidation in each case:

| Case | Subsidiary Company | % of Share Owned | Cost | Date of Acquisition | | Consolidation date | |
|---|---|---|---|---|---|---|---|
| | | | | 01-01-2019 | | 31-12-2019 | |
| | | | | Share Capital | Profit and Loss A/c | Share Capital | Profit and Loss A/c |
| | | | | ₹ | ₹ | ₹ | ₹ |
| Case-A | X | 90% | 2,00,000 | 1,50,000 | 75,000 | 1,50,000 | 85,000 |
| Case-B | Y | 75% | 1,75,000 | 1,40,000 | 60,000 | 1,40,000 | 20,000 |
| Case-C | Z | 70% | 98,000 | 40,000 | 20,000 | 40,000 | 20,000 |
| Case-D | M | 95% | 75,000 | 60,000 | 35,000 | 60,000 | 55,000 |
| Case-E | N | 100% | 1,00,000 | 40,000 | 40,000 | 40,000 | 65,000 |

(*RTP, November, 2020*)

**Answer**

**(a)** As per para provisions of AS 21, Intragroup balances and intragroup transactions and resulting unrealized profits should be eliminated in full. Unrealized losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.

Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealised profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full. Unrealised losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered. One also needs to see whether the intragroup transaction is "upstream" or "down-stream". Upstream transaction is a transaction in which the subsidiary company sells goods to holding company. While in the downstream transaction, holding company is the seller and subsidiary company is the buyer.

In the case of upstream transaction, since the goods are sold by the subsidiary to holding company; profit is made by the subsidiary company, which is ultimately shared by the holding company and the minority shareholders. In such a transaction, if some goods remain unsold at the balance sheet date, the unrealized profit on such goods should be eliminated from minority interest as well as from consolidated profit on the basis of their share-holding besides deducting the same from unsold inventory.

But in the case of downstream transaction, the whole profit is earned by the holding company, therefore, whole unrealized profit should be adjusted from unsold inventory and consolidated profit and loss account only irrespective of the percentage of the shares held by the parent.

The case given in the question is the case of upstream transaction. In the consolidated profit and loss account for the year ended 31 March 2019 , entire transaction of sale and purchase of ₹ 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales). Further, the unrealized profits of ₹ 50 lacs (i.e. ₹ 200 lacs – ₹ 150 lacs), would be eliminated in the consolidated financial statements for financial year ended 31 March 2019, by reducing the value of closing inventories by ₹ 50 lacs as of 31 March 2019. In the consolidated balance sheet as of 31 March 2019, A Ltd's share of profit from B Ltd will be reduced by ₹ 37.50 lacs (being 75% of ₹ 50 lacs) and the minority's share of the profits of B Ltd would be reduced by ₹ 12.50 lacs (being 25% of ₹ 50 lacs).

**(b)** Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case, it should be equal to Share Capital + Profit & Loss A/c

A = Share capital on 1.1.2019

B = Profit & loss account balance on 1.1.2019

C = Share capital on 31.12.2019

D = Profit & loss account balance on 31.12.2019

| | Minority % Shares Owned<br>[E] | Minority interest as at the date of acquisition<br>[E] x [A + B] ₹ | Minority interest as at the date of consolidation<br>[E] X [C + D] ₹ |
|---|---|---|---|
| Case A [100-90] | 10 % | 22,500 | 23,500 |
| Case B [100-75] | 25 % | 50,000 | 40,000 |
| Case C [100-70] | 30 % | 18,000 | 18,000 |
| Case D [100-95] | 5% | 4,750 | 5,750 |
| Case E [100-100] | NIL | NIL | NIL |

## Question 66

Hemant Ltd. purchased 80% shares of Power Ltd. on 1st January, 2019 for ₹ 2,10,000. The issued capital of Power Ltd., on 1st January, 2019 was ₹ 1,50,000 and the balance in the Profit & Loss Account was ₹ 90,000. During the year ended 31st December, 2019, Power Ltd. earned a profit of ₹ 30,000 and at year end, declared and paid a dividend of ₹ 22,500.

What is the amount of minority interest as on 1st January, 2019 and 31st December, 2019? Also compute goodwill/ capital reserve at the date of acquisition.

(*MTP, October, 2020*) (*6 marks*)

**Answer**

Total dividend paid is ₹ 22,500 (out of post-acquisition profits), hence dividend received by Hemant will be credited to P & L account. Hemant Ltd.'s share of dividend = ₹ 22,500 X 80% = ₹ 18,000

| ***Goodwill on consolidation* (*at the date of acquisition*):** | ₹ | ₹ |
|---|---|---|
| Cost of shares | | 2,10,000 |
| *Less:* Face value of capital i.e. 80% of capital | 1,20,000 | |
| *Add:* Share of capital profits [90,000 X 80 %] | 72,000 | (1,92,000) |
| Goodwill | | 18,000 |
| ***Minority interest on***: | | |
| - **1st January, 2019:** | | |
| 20% of ₹ 2,40,000 [1,50,000 + 90,000] | | 48,000 |
| - **31st December, 2019:** | | 49,500 |
| 20% of ₹2,47,500 [1,50,000 + 90,000 + 30,000 – 22,500] | | |

## Question 67

A Ltd. holds 80% of the equity capital and voting power in B Ltd. A Ltd sells inventories costing ₹ 180 lacs to B Ltd at a price of ₹ 200 lacs. The entire inventories remain unsold with B Ltd at the financial year end i.e. 31 March 2020. What will be the accounting treatment for this transaction in the consolidated financial statements of A Ltd?

(*MTP, October, 2020*) (*4 marks*)

**Answer**

This would be the case of downstream transaction. In the consolidated profit and loss account for the year ended 31 March 2020, entire transaction of sale and purchase of ₹ 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales). Further, the unrealized profits of ₹ 20 lacs (i.e. ₹ 200 lacs – ₹ 180 lacs), would be eliminated from the consolidated financial statements for financial year ended 31 March 2020, by reducing the consolidated profits/ increasing the consolidated losses, and reducing the value of closing inventories as of 31 March 2020.

## Question 68

A Ltd. and its subsidiary B Ltd. give the following information for the year ended 31st March, 2020:

₹ in Lakhs

| | **A Ltd.** | **B Ltd.** |
|---|---|---|
| Sales and other income | 7,500 | 1,500 |
| Increase in Inventory | 1,500 | 300 |
| Raw material consumed | 1,200 | 300 |
| Wages and Salaries | 1,200 | 225 |
| Production expenses | 300 | 150 |
| Administrative expenses | 300 | 150 |
| Selling and distribution expenses | 300 | 75 |
| Interest | 150 | 75 |
| Depreciation | 150 | 75 |

The following information is also given:

(i) A Ltd sold goods of ₹ 180 Lakhs to B Ltd at cost plus 25% (1/6 of such goods were still in inventory of B Ltd at the end of the year).

(ii) A Ltd. holds 72% of the Equity Capital of B Ltd and the Equity Capital of B Ltd is ₹1,500 Lakhs on 1.4.2019 (date of acquisition of shares).

(iii) Administrative expenses of B Ltd include ₹ 8 Lakhs paid to A Ltd as consultancy fees. Moreover, selling and distribution expenses of A Ltd include ₹15 Lakhs paid to B Ltd as commission.

You are required to prepare a consolidated Statement of Profit and Loss Account of A Ltd. with its subsidiary B Ltd. for the year ended 31st March, 2020.

(*MTP, March, 2021*) (*15 marks*)

**Answer**

**Consolidated Profit & Loss Account of A Ltd. and its subsidiary B Ltd.**
**for the year ended on 31st March, 2020**

| ***Particulars*** | ***Note No.*** | ***₹ in Lacs*** |
|---|---|---|
| (I) Revenue from operations | 1 | 8,797 |
| (II) Total revenue | | 8,797 |
| (III) Expenses | | |
| Cost of Material purchased/consumed | 3 | 1,770 |

| **Particulars** | **Note No.** | **₹ in Lacs** |
|---|---|---|
| Changes of Inventories of finished goods | 2 | (1,794) |
| Employee benefit expense | 4 | 1,425 |
| Finance cost | 6 | 225 |
| Depreciation and amortization expense | 7 | 225 |
| Other expenses | 5 | 802 |
| Total expenses | | 2,653 |
| (IV) Profit before Tax(II-III) | | 6,144 |

**Notes to Accounts**

| | | **₹ in Lacs** | **₹ in Lacs** |
|---|---|---|---|
| 1. | Revenue from Operations | | |
| | Sales and other income | | |
| | A Ltd. | 7,500 | |
| | B Ltd. | 1,500 | |
| | | 9,000 | |
| | *Less:* Inter-company Sales | (180) | |
| | Consultancy fees received by A Ltd. from B Ltd. | (8) | 8,797 |
| | Commission received by B Ltd. from A Ltd. | (15) | |
| 2. | Increase in Inventory | | |
| | A Ltd. | 1,500 | |
| | B Ltd. | 300 | |
| | | 1,800 | |
| | *Less:* Unrealized profits ₹ 180×1/6 x 25/125 | (6) | 1,794 |
| 3. | Cost of Material purchased/consumed | | |
| | A Ltd. | 1,200 | |
| | B Ltd. | 300 | |
| | | 1,500 | |
| | *Less*: Purchases by B Ltd. from A Ltd. | (180) | 1,320 |
| | Direct Expenses | | |
| | A Ltd. | 300 | |
| | B Ltd. | 150 | 450 |
| | | | 1,770 |
| 4. | Employee benefits and expenses | | |
| | Wages and Salaries: | | |
| | A Ltd. | 1,200 | |
| | B Ltd. | 225 | 1,425 |
| 5. | Other Expenses | | |
| | Administrative Expenses | | |
| | A Ltd. | 300 | |
| | B Ltd. | 150 | |
| | | 450 | |
| | *Less*: Consultancy fees received by A Ltd. from B Ltd. | (8) | 442 |
| | Selling and Distribution Expenses: | | |
| | A Ltd. | 300 | |
| | B Ltd. | 75 | |
| | | 375 | |
| | *Less*: Commission received from B Ltd. from A Ltd. | (15) | 360 |
| | | | 802 |
| 6. | Finance Cost | | |
| | Interest: | | |
| | A Ltd. | 150 | |
| | B Ltd. | 75 | 225 |
| 7. | Depreciation and Amortization | | |
| | Depreciation: | | |
| | A Ltd. | 150 | |
| | B Ltd. | 75 | 225 |

## Question 69

(a) H Ltd. and its subsidiary S Ltd. Give the following information as on 31st March, 2021:

| | H Ltd. (₹) | S Ltd. (₹) |
|---|---|---|
| **Share Capital** | | |
| Equity Share Capital (fully paid up shares of ₹ 10 each) | 12,00,000 | 2,00,000 |
| **Reserves and Surplus** | | |
| General Reserve | 4,35,000 | 1,55,000 |
| Cr. Balance in Profit and Loss Account | 2,80,000 | 65,000 |
| **Current Liabilities** | | |
| Trade Payables | 3,22,000 | 1,23,000 |
| **Non-Current Assets** | | |
| Property, Plant and Equipment | | |
| Machinery | 6,40,000 | 1,80,000 |
| Furniture | 3,75,000 | 34,000 |
| **Non-Current Investments** | | |
| Shares in S Ltd. - 16,000 shares @ ₹ 20 each | 3,20,000 | - |
| **Current Assets** | | |
| Inventories | 2,68,000 | 62,000 |
| Trade Receivables | 4,70,000 | 2,35,000 |
| Cash and Bank | 1,64,000 | 32,000 |

H Ltd. acquired the 80% shares of S Ltd. on 1st April, 2020. On the date of acquisition, General Reserve and Profit Loss Account of S Ltd. stood at ₹ 50,000 and ₹ 30,000 respectively.

Machinery (book value ₹ 2,00,000) and Furniture (book value ₹ 40,000) of S Ltd. were revalued at ₹ 3,00,000 and ₹ 30,000 respectively on 1st April,2020 for the purpose of fixing the price of its shares (rates of depreciation on W.D.V basis: Machinery 10% and Furniture 15%). Trade Payables of H Ltd. include ₹ 35,000 due to S Ltd. for goods supplied since the acquisition of the shares. These goods are charged at 10% above cost. The inventories of H Ltd. includes goods costing ₹ 55,000 (cost to H Ltd.) purchased from S Ltd.

You are required to prepare the Consolidated Balance Sheet of H Ltd. With its subsidiary as at 31st March, 2021.

(*MTP, April, 2021*) (*16 marks*)

**Answer**

**(a) Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd.**
**as at 31st March, 2021**

| ***Particulars*** | ***Note No.*** | **(₹)** |
|---|---|---|
| I. Equity and Liabilities | | |
| (1) Shareholder's Funds | | |
| (a) Share Capital (1,20,000 equity shares of ₹ 10 each) | | 12,00,000 |
| (b) Reserves and Surplus | | |
| (2) Minority Interest (W.N.4) | | |
| (3) Current Liabilities | 1 | 8,16,200 |
| (a) Trade Payables | | 99,300 |
| II. Assets Total | 2 | 4,10,000 |
| (1) Non-current assets | | 25,25,500 |
| (i) Property, plant and equipment | | |
| (ii) Intangible assets | | |
| | 3 | 13,10,500 |
| | 4 | 24,000 |
| (2) Current assets | | |
| (i) Inventories | 5 | 3,25,000 |
| (ii) Trade Receivables | 6 | 6,70,000 |
| (iii) Cash at Bank | 7 | 1,96,000 |
| Total | | 25,25,500 |

**Notes to Accounts**

| | | ₹ | | |
|---|---|---|---|---|
| 1. | Reserves and Surplus | | | |
| | General Reserves | | 4,35,000 | |
| | *Add:* 80% share of S Ltd.'s post-acquisition reserves (W.N.3) | | 84,000 | 5,19,000 |
| | Profit and Loss Account | | 2,80,000 | |
| | *Add:* 80% share of S Ltd.'s post-acquisition profits (W.N.3) | 21,200 | | |
| | *Less:* Unrealised gain | (4,000) | 17,200 | 2,97,200 |
| | | | | 8,16,200 |
| 2. | Trade Payables | | | |
| | H Ltd. | | 3,22,000 | |
| | S Ltd. | | 1,23,000 | |
| | *Less:* Mutual transaction | | (35,000) | 4,10,000 |
| 3. | Property, plant and equipment | | | |
| | Machinery | | | |
| | H Ltd. | | 6,40,000 | |
| | S Ltd. | 2,00,000 | | |
| | *Add:* Appreciation | 1,00,000 | | |
| | | 3,00,000 | | |
| | *Less:* Depreciation | (30,000) | 2,70,000 | 9,10,000 |
| | Furniture | | | |
| | H. Ltd. | | 3,75,000 | |
| | S Ltd. | 40,000 | | |
| | *Less:* Decrease in value | (10,000) | | |
| | | 30,000 | | |
| | *Less*: Depreciation | (4,500) | 25,500 | 4,00,500 |
| | | | | 13,10,500 |
| 4. | Intangible assets | | | |
| | Goodwill [WN 5] | | | 24,000 |
| 5. | Inventories | | | |
| | H Ltd. | | 2,68,000 | |
| | S Ltd. | | 62,000 | 3,30,000 |
| | *Less:* Inventory reserve | | | (5,000) |
| | | | | 3,25,000 |
| 6. | Trade Receivables | | | |
| | H Ltd. | | 4,70,000 | |
| | S Ltd. | | 2,35,000 | |
| | | | | 7,05,000 |
| | *Less:* Mutual transaction | | | (35,000) |
| | | | | 6,70,000 |
| 7. | Cash and Bank H Ltd. | | 1,64,000 | |
| | S Ltd. | | 32,000 | 1,96,000 |

**Working Notes:**

**1. Profit or loss on revaluation of assets in the books of S Ltd. and their book values as on 1.4.2020**

| | ₹ |
|---|---|
| ***Machinery*** | |
| Revaluation as on 1.4.2020 | 3,00,000 |
| Less: Book value as on 1.4.2020 | (2,00,000) |
| Profit on revaluation | 1,00,000 |
| ***Furniture*** | |
| Revaluation as on 1.4.2020 | 30,000 |
| Less: Book value as on 1.4.2020 | (40,000) |
| Loss on revaluation | (10,000) |

**2. Calculation of short/excess depreciation**

| | ***Machinery*** | ***Furniture*** |
|---|---|---|
| Upward/ (Downward) Revaluation | 1,00,000 | (10,000) |
| Rate of depreciation | 10% p.a. | 15% p.a. |
| Difference [(short)/excess] | (10,000) | 1,500 |

**3. Analysis of reserves and profits of S Ltd. as on 31.03.2021**

| | ***Pre-acquisition profit upto 1.4.2020*** | ***Post-acquisition profits (1.4.2020 – 31.3.2021)*** | |
|---|---|---|---|
| | **(*Capital profits*)** | ***General Reserve*** | ***Profit and loss account*** |
| General reserve as on 31.3.2021 | 50,000 | 1,05,000 | |
| Profit and loss account as on 31.3.2021 | 30,000 | | 35,000 |
| Upward Revaluation of machinery as on 1.4.2020 | 1,00,000 | | |
| Downward Revaluation of Furniture as on 1.4.2020 | (10,000) | | |
| Short depreciation on machinery | | | (10,000) |
| Excess depreciation on furniture | | | 1,500 |
| Total | | | 26,500 |
| | 1,70,000 | 1,05,000 | |

**4. Minority Interest**

| | ₹ |
|---|---|
| Paid-up value of (2,00,000 x 20%) | 40,000 |
| *Add:* 20% share of pre-acquisition profits and reserves | |
| [(20% of (50,000 + 30,000)] | 16,000 |
| 20% share of profit on revaluation | 18,000 |
| 20% share of post-acquisition reserves | 21,000 |
| 20% share of post-acquisition profit | 5,300 |
| | 1,00,300 |
| Less: Unrealised Profit on Inventory | |
| (55,000 x 10/110) x 20% | (1,000) |
| | 99,300 |

**5. Cost of Control or Goodwill**

| | | |
|---|---|---|
| Cost of Investment | | 3,20,000 |
| Less: Paid-up value of 80% shares | 1,60,000 | |
| 80% share of pre-acquisition profits and reserves (₹ 64,000 + ₹72,000) | 1,36,000 | (2,96,000) |
| Cost of control or Goodwill | | 24,000 |

## Question 70

A Ltd. acquired 70% equity shares of B Ltd. @ ₹20 per share (Face value - ₹10) on 31st March, 2021 at a cost of ₹ 140 lakhs. Calculate the amount of share of A Ltd. and minority interest in the net assets of B Ltd. on this date. Also compute goodwill/capital reserve for A Ltd. on acquisition of shares of B Ltd. from the following information available from the balance sheet of B Ltd. as on 31st March, 2021:

| | **₹ in lakhs** |
|---|---|
| Property, plant and equipment | 360 |
| Investments | 90 |
| Current Assets | 140 |
| Loans & Advances | 30 |
| 15% Debentures | 180 |
| Current Liabilities | 100 |

(*RTP, May, 2021*)

**Answer**

**Net assets of B Ltd. as on 31st March, 2021**

| | *₹ in lakhs* | *₹ in lakhs* |
|---|---|---|
| Property, plant and equipment | | 360 |
| Investments | | 90 |
| Current Assets | | 140 |
| Loans and Advances | | 30 |
| Total Assets | | 620 |
| *Less:* 15% Debentures | 180.0 | |
| Current Liabilities | 100.0 | (280) |
| Equity / Net Worth | | 340 |
| Share of Minority Interest in net assets (30% of 340) | | 102 |
| A Ltd.'s share in net assets (70% of 340) | | 238 |
| A Ltd.'s cost of acquisition of shares of B Ltd. | | |
| (₹140 lakhs) | | (140) |
| Capital reserve | | 98 |

## Question 71

H Limited acquired 64000 Equity Shares of ₹ 10 each in S Ltd. as on 1st October, 2019. The Balance Sheets of the two companies as on 31st March, 2020 were as under:

| Particulars | H Ltd. (₹) | S Ltd. (₹) |
|---|---|---|
| Equities and Liabilities: | | |
| Equity Share Capital: Shares of ₹ 10 each | 20,00,000 | 8,00,000 |
| General Reserve (1st April, 2019) | 9,60,000 | 4,20,000 |
| Profit & Loss Account | 2,28,800 | 3,28,000 |
| Preliminary Expenses (1st April, 2019) | - | (20,000) |
| Bank Overdraft | 3,00,000 | - |
| Bills Payable | - | 52,000 |
| Trade Payables | 1,66,400 | 80,000 |
| Total | 36,55,200 | 16,60,000 |
| Assets: | | |
| Land and Building | 7,20,000 | 7,60,000 |
| Plant & Machinery | 9,60,000 | 5,40,000 |
| Investment in Equity Shares of S Ltd. | 12,27,200 | - |
| Inventories | 4,56,000 | 1,68,000 |
| Trade Receivables | 1,76,000 | 1,60,000 |
| Bills Receivable | 59,200 | - |
| Cash in Hand | 56,800 | 32,000 |
| Total | 36,55,200 | 16,60,000 |

Additional Information:

*(1)* The Profit & Loss Account of S Ltd. showed credit balance of ₹ 1,20,000 on 1st April, 2019. S Ltd. paid a dividend of 10% out of the same on 1st November, 2019 for the year 2018-19. The dividend was correctly accounted for by H Ltd.

*(2)* The Plant & Machinery of S Ltd. which stood at ₹ 6,00,000 on 1st April, 2019 was considered worth ₹ 5,20,000 on the date of acquisition by H Ltd. S Ltd. charges depreciation @ 10% per annum on Plant & Machinery.

Prepare consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31st March, 2020 as per Schedule III of the Companies Act, 2013.

(*Suggested, November, 2020*) (*15 marks*)

**Answer**

**Consolidated Balance Sheet of H Ltd. and its subsidiary, S Ltd. as at 31st March, 2020**

| Particulars | Note No. | (₹) |
|---|---|---|
| I. Equity and Liabilities | | |
| (1) Shareholder's Funds | | |
| (a) Share Capital | 1 | 20,00,000 |
| (b) Reserves and Surplus | 2 | 13,07,200 |
| (2) Minority Interest (W.N 4) | | 2,96,400 |

| Particulars | Note No. | (₹) |
|---|---|---|
| (3) Current Liabilities | | |
| (a) Trade Payables | 3 | 2,98,400 |
| (b) Short term borrowings | | 3,00,000 |
| Total | | 42,02,000 |
| II. Assets | | |
| (1) Non-current assets | | |
| (i) Property, Plant and Equipment | 4 | 29,34,000 |
| (ii) Intangible assets (W.N.5) | | 1,60,000 |
| (2) Current assets | | |
| (a) Inventories | 5 | 6,24,000 |
| (b) Trade receivables | 6 | 3,95,200 |
| (c) Cash & Cash equivalents (Cash) | 7 | 88,800 |
| Total | | 42,02,000 |

**Notes to Accounts**

| | | | ₹ | ₹ |
|---|---|---|---|---|
| 1. | Share Capital | | | |
| | 2,00,000 equity shares of ₹ 10 each | | | 20,00,000 |
| 2. | Reserves and Surplus | | | |
| | Reserves | | 9,60,000 | |
| | Profit & loss | | | |
| | H Ltd. | 2,28,800 | | |
| | S Ltd. (As per W.N. 3) | 1,18,400 | 3,47,200 | 13,07,200 |
| 3. | Trade Payables | | | |
| | H Ltd. | | 1,66,400 | |
| | S Ltd. (80,000+52,000) | | 1,32,000 | 2,98,400 |
| 4. | Property, Plant and Equipment | | | |
| | Land and building | | | |
| | H Ltd. | 7,20,000 | | |
| | S Ltd. | 7,60,000 | 14,80,000 | |
| | Plant & Machinery | | | |
| | H Ltd. | 9,60,000 | | |
| | S Ltd. (As per W.N. 7) | 4,94,000 | 14,54,000 | 29,34,000 |
| 5. | Inventories H Ltd. | | | |
| | S Ltd. | | 4,56,000 | |
| | | | 1,68,000 | 6,24,000 |
| 6. | Trade Receivables | | | |
| | H Ltd. | 1,76,000 | | |
| | S Ltd. | 1,60,000 | 3,36,000 | |
| | Bills receivable: H Ltd. | | 59,200 | 3,95,200 |
| 7. | Cash & Cash equivalents | | | |
| | Cash | | | |
| | H Ltd. | | 56,800 | |
| | S Ltd. | | 32,000 | 88,800 |

**Working Notes:**

1. **Share holding pattern**
   Total Shares of S Ltd 80,000 shares
   Shares held by H Ltd 64,000 shares i.e. 80 %;
   Minority Shareholding 16,000 shares i.e. 20 %
2. **Capital profits of S Ltd.**

| | ₹ | ₹ |
|---|---|---|
| Reserve on 1st October, 2019 (Assumed there is no movement in reserves during the year and hence balance as on 1st October, 2019 is same as of 31st March 2020) | | 4,20,000 |
| Profit & Loss Account Balance on 1st April, 2019 | 1,20,000 | |

| | ₹ | ₹ |
|---|---|---|
| *Less:* Dividend paid | (80,000) | 40,000 |
| Profit for year: | | |
| Total ₹ 3,28,000 | | |
| Less: ₹ 40,000 (opening balance) | | |
| ₹ 2,88,000 | | |
| Proportionate up to 1st October, 2019 on time basis (₹ 2,88,000/2) | | 1,44,000 |
| Reduction in value of Plant & Machinery (WN 6) | | (50,000) |
| | | 5,54,000 |
| Less: Preliminary expenses written off | | (20,000) |
| Total Capital Profit | | 5,34,000 |
| Holding company's share (5,34,000 X 80%) | | 4,27,200 |
| Minority Interest (5,34,000 X 20%) | | 1,06,800 |

**Note:** Preliminary expenses as on 1st April, 2019 amounting ₹ 20,000 have been written off.

3. **Revenue profits of S Ltd.**

| | | |
|---|---|---|
| Profit after 1st October, 2019 (3,28,000 - 40,000)/2 | | 1,44,000 |
| *Less* 10% depreciation on ₹5,20,000 for 6 months | (26,000) | |
| Add: Depreciation already charged for 2nd half year on 6,00,000 | 30,000 | |
| | | 4,000 |
| | | 1,48,000 |
| Holding company's share (1,48,000 X 80%) | | 1,18,400 |
| Minority Interest (1,48,000 X 20%) | | 29,600 |

4. **Minority interest**

| | |
|---|---|
| Par value of 16,000 shares (8,00,000 X 20%) | 1,60,000 |
| *Add:* 1/5 Capital Profits [WN 2] | 1,06,800 |
| 1/5 Revenue Profits [WN 3] | 29,600 |
| | 2,96,400 |

5. **Cost of Control**

| | | |
|---|---|---|
| Amount paid for 64,000 shares | | 12,27,200 |
| *Less:* | | |
| Par value of shares (8,00,000 X 80%) | 6,40,000 | |
| Capital Profits – share of H Ltd. [WN 2] | 4,27,200 | (10,67,200) |
| Cost of Control or Goodwill | | 1,60,000 |

6. **Calculation of revaluation loss on Plant and Machinery of S Ltd. on 1st October, 2019**

| | ₹ |
|---|---|
| Value of plant and machinery as on 1st April,2019 | 6,00,000 |
| Less: Depreciation for the six months | (30,000) |
| Value of plant and machinery as on 1st October, 2019 | 5,70,000 |
| Less: Plant and machinery valued by H Ltd. on 1st October,2019 | (5,20,000) |
| Revaluation Loss | 50,000 |

7. **Value of plant & Machinery of S Ltd. On 31st March,2020**

| | |
|---|---|
| Value of machinery on 1st October, 2019 | 5,20,000 |
| Less: depreciation for next six month | (26,000) |
| | 4,94,000 |

## Question 72

On 31st March, 2020 the summarised Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

| | H Ltd. | S Ltd. |
|---|---|---|
| | ₹ | ₹ |
| **Shareholders' Fund** | | |
| Issued and subscribed | | |
| Equity shares of ₹ 10 each | 13,40,000 | 2,40,000 |
| Reserves and Surplus | 4,80,000 | 1,80,000 |
| Profit & Loss Account | 2,40,000 | 60,000 |

| | H Ltd. | S Ltd. |
|---|---|---|
| | ₹ | ₹ |
| **Secured Loans** | | |
| 12% Debentures | 1,00,000 | - |
| **Current Liabilities** | | |
| Trade Payables | 2,00,000 | 1,22,000 |
| Bank Overdraft | 1,00,000 | - |
| Bills Payable | 60,000 | 14,800 |
| Total | 25,20,000 | 6,16,800 |
| **Assets** | | |
| **Non-Current Assets** | • | |
| **(a) Property, Plant & Equipment** | . | |
| Machinery | 7,20,000 | 2,16,000 |
| Furniture | 3,60,000 | 40,800 |
| **(b) Investments** | | |
| Investments in S Ltd. | 3,84,000 | - |
| (19,200 shares at ₹ 20 each) | | |
| **Current Assets** | | |
| Inventories | 6,00,000 | 2,00,000 |
| Trade Receivables | 3,00,000 | 90,000 |
| Bill Receivables | 1,00,000 | 30,000 |
| Cash at Bank | 56,000 | 40,000 |
| Total | 25,20,000 | 6,16,800 |

The following information is also provided to you:

(a) H Ltd. purchased 19,200 shares of S Ltd. on 1st April, 2019, when the balances of Reserves & Surplus and Profit & Loss Account of S Ltd. stood at ₹ 60,000 and ₹ 36,000 respectively.

(b) Machinery (Book value ₹ 2,40,000) and Furniture (Book value ₹ 48,000) of S Ltd were revalued at ₹ 3,60,000 and ₹ 36,000 respectively on 1st April, 2019, for the purpose of fixing the price of its shares. (Rates of depreciation computed on the basis of useful lives:
Machinery 10%, Furniture 15%).

(c) On 31st March, 2020, Bills payable of ₹ 12,000 shown in S Ltd.'s Balance Sheet had been accepted in favour of H Ltd.

You are required to prepare Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2020.

(*Suggested, January, 2021) (20 marks*)

**Answer**

**Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2020**

| Particulars | Note No. | (₹) |
|---|---|---|
| **I. Equity and Liabilities** | | |
| **(1) Shareholder's Funds** | | |
| (a) Share Capital | 1 | 13,40,000 |
| (b) Reserves and Surplus | 2 | 8,27,040 |
| **(2) Minority Interest** | | 1,15,560 |
| **(3) Non- Current Liabilities** | | 1,00,000 |
| (a) 12% Debentures | | |
| **(4) Current Liabilities** | 3 | 3,84,800 |
| (a) Trade Payables | | 1,00,000 |
| (b) Short term Borrowings (Bank overdraft) | | 28,67,400 |
| Total | | |
| **II. Assets** | | |
| **(1) Non-current assets** | | |
| (a) | | |
| (i) Property, Plant and Equipment | 4 | 14,34,600 |
| (ii) Intangible assets | 5 | 28,800 |
| **(2) Current assets** | | |
| (a) Inventory (6,00,000+2,00,000) | | 8,00,000 |
| (b) Trade Receivables | 6 | 5,08,000 |
| (c) Cash and Cash equivalents | | 96,000 |
| Total | | 28,67,400 |

**Notes to Accounts**

| | | | | ₹ |
|---|---|---|---|---|
| 1. | Share Capital | | | |
| | Equity share capital | | | 13,40,000 |
| | 1,34,000 shares of ₹ 10 each fully paid up Reserves and | | | |
| 2. | Surplus | | | |
| | Reserves | | 4,80,000 | |
| | *Add:* 4/5th share of S Ltd.'s post-acquisition reserves (W.N.3) | | 96,000 | 5,76,000 |
| | Profit and Loss Account | | 2,40,000 | |
| | *Add:* 4/5th share of S Ltd.'s post- acquisition profits (W.N.4) | | 11,040 | 2,51,040 |
| | | | | 8,27,040 |
| 3. | Trade Payables | | | |
| | H Ltd. | 2,00,000 | | |
| | S Ltd. | 1,22,000 | 3,22,000 | |
| | Bills Payables | | | |
| | | 60,000 | | |
| | H Ltd. | 14,800 | 74,800 | |
| | S Ltd. | | 3,96,800 | |
| | | | (12,000) | 3,84,800 |
| | Less: Mutual Owings | | | |
| 4. | | | 7,20,000 | |
| | Property Plant and Equipment | | | |
| | Machinery | 2,40,000 | | |
| | H. Ltd. | | | |
| | S Ltd. | 1,20,000 | | |
| | Add: Appreciation | 3,60,000 | | |
| | | (36,000) | 3,24,000 | |
| | Less: Depreciation (3,60,000 X 10%) | | | |
| | Furniture | | | |
| | H. Ltd. | | 3,60,000 | |
| | S Ltd. | 48,000 | | |
| | Less: Decrease in value | (12,000) | | |
| | | 36,000 | | |
| | | 5,400 | 30,600 | 14,34,600 |
| | Less: Depreciation (36,000 X 15%) | | | |
| 5. | Intangible assets | | | |
| | Goodwill [WN 6] | | | 28,800 |
| 6. | | | | |
| | Trade receivables | 3,00,000 | | |
| | H Ltd. | 90,000 | 3,90,000 | |
| | S Ltd. | 1,00,000 | | |
| | Bills Receivables | 30,000 | 1,30,000 | |
| | H Ltd. | | 5,20,000 | |
| | S Ltd. | | (12,000) | 5,08,000 |
| | Less: Mutual Owings | | | |

**Working Notes:**

| | | ₹ |
|---|---|---|
| 1. | Pre-acquisition profits and reserves of S Ltd. | |
| | Reserves | 60,000 |
| | Profit and Loss Account | 36,000 |
| | | 96,000 |
| | H Ltd.'s = 4/5 (or 80%) × 96,000 | 76,800 |
| | Minority Interest= 1/5 (or 20%) × 96,000 | 19,200 |
| 2. | Profit on revaluation of assets of S Ltd. | |
| | Profit on Machinery ₹ (3,60,000 – 2,40,000) | 1,20,000 |
| | *Less*: Loss on Furniture ₹(48,000 –36,000) | (12,000) |
| | Net Profit on revaluation | 1,08,000 |
| | H Ltd.'s share 4/5 × 1,08,000 | 86,400 |
| | Minority Interest 1/5 × 1,08,000 | 21,600 |

| | | |
|---|---|---|
| 3. | Post-acquisition reserves of S Ltd. | |
| | Total reserves | 1,80,000 |
| | Less: Pre- acquisition reserves | <u>(60,000)</u> |
| | Post-acquisition reserves | 1,20,000 |
| | H Ltd.'s share 4/5 × 1,20,000 | 96,000 |
| | Minority interest 1/5 × 1,20,000 | 24,000 |
| 4. | Post -acquisition profits of S Ltd. | |
| | Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = ₹ 60,000 – 36,000) | 24,000 |
| | *Add:* Excess depreciation charged on furniture @ 15% | |
| | on ₹ 12,000 i.e. (48,000 – 36,000) | <u>1,800</u> |
| | | 25,800 |
| | *Less*: Under depreciation on machinery @ 10% on ₹ 1,20,000 i.e. (3,60,000 – 2,40,000) | <u>(12,000)</u> |
| | Adjusted post-acquisition profits | <u>13,800</u> |
| | H Ltd.'s share 4/5 × 13,800 | 11,040 |
| | Minority Interest 1/5 × 13,800 | 2,760 |
| 5. | Minority Interest | |
| | Paid-up value of (24,000 – 19,200) = 4,800 shares | |
| | held by outsiders i.e. 2,40,000 X 20% | 48,000 |
| | *Add:* 1/5th share of pre-acquisition profits and reserves | 19,200 |
| | 1/5th share of profit on revaluation | 21,600 |
| | 1/5th share of post-acquisition reserves | 24,000 |
| | 1/5th share of post-acquisition profit | <u>2,760</u> |
| | | 1,15,560 |
| 6. | Cost of Control or Goodwill | |
| | Price paid by H Ltd. for 19,200 shares (A) | 3,84,000 |
| | *Less:* Intrinsic value of the shares | |
| | Paid-up value of shares held by H Ltd. i.e. 2,40,000 X 80% | 1,92,000 |
| | *Add:* 4/5th share of pre-acquisition profits and reserves | 76,800 |
| | 4/5th share of profit on the revaluation | 86,400 |
| | Intrinsic value of shares on the date of acquisition (B) | <u>3,55,200</u> |
| | Cost of control or Goodwill (A – B) | 28,800 |

## Question 73

The Trial Balances of X Limited and Y Limited as on 31st March, 2021 were as under:

| | X Limited (₹ In 000) | | Y Limited (₹ In 000) | |
|---|---|---|---|---|
| | **Dr.** | **Cr.** | **Dr.** | **Cr.** |
| Equity Share capital (Share of ₹ 100 each) | | 2,000 | | 400 |
| 7% Preference share capital | | - | | 400 |
| Reserves | | 600 | | 200 |
| 6% Debentures | | 400 | | 400 |
| Trade Receivables/Trade Payables | 160 | 180 | 100 | 120 |
| Profit & Loss A/c balance | | 40 | | 30 |
| Purchases/Sales | 1,000 | 1,800 | 1,200 | 1,900 |
| Wages and Salaries | 200 | | 300 | |
| Debenture Interest | 24 | | 24 | |
| General Expenses | 160 | | 120 | |
| Preference share dividend up to 30.09.2020 | | 7 | 14 | |
| Inventory (as on 31.03.2021) | 200 | | 100 | |
| Cash at Bank | 27 | | 12 | |
| Investment in Y Limited | 1,056 | | - | |
| Fixed Assets | 2,200 | | 1,580 | |
| Total | 5,027 | 5,027 | 3,450 | 3,450 |

Investment in Y Limited was acquired on 1st July, 2020 and consisted of 80% of Equity Share Capital and 50% of Preference Share Capital.

– After acquiring control over Y Limited, X Limited supplied to Y Limited goods at cost plus 25%, the total invoice value of such goods being ₹ 1,20,000, one fourth of such goods were still lying in inventory at the end of the year.

– Depreciation to be charged @ 10% in X Limited and @ 15% in Y Limited on Fixed Assets.

You are required to prepare the Consolidated Statement of Profit and Loss for the year ended on 31st March, 2021.

(*July, 2021 Suggested*) (*15 Marks*)

**Answer**

**Consolidated Profit and Loss Account of X Ltd. and Y Ltd. for the year ended 31st March, 2021**

| Particulars | | Note No. | ₹ |
|---|---|---|---|
| I. | Revenue from operations | 1 | 35,80,000 |
| II. | Total revenue | | 35,80,000 |
| III. | Expenses | | |
| | Cost of Material purchased/Consumed | 2 | 20,80,000 |
| | Changes of Inventories of finished goods | | - |
| | Employee benefit expense | 3 | 5,00,000 |
| | Finance cost | 4 | 48,000 |
| | Depreciation and amortization expense | 5 | 4,57,000 |
| | Other expenses | 6 | 2,80,000 |
| | Total expenses | | 33,65,000 |
| IV. | Profit before Tax (II-III) | | 2,15,000 |
| | Profit transferred to Consolidated Balance Sheet | | |
| | Profit After Tax | | 2,15,000 |
| | Preference dividend | 7,000 | |
| | Preference dividend payable | 7,000 | (14,000) |
| | | | 2,01,000 |
| Share in pre-acquisition loss (WN 3) | | | 1,800 |
| Share of Minority interest in losses (WN 1) | | | 1,800 |
| Less: Investment Account- dividend for 3 months (prior to acquisition) | | | (3,500) |
| Inventory reserve (WN 2) | | | (6,000) |
| Profit to be transferred to consolidated balance sheet | | | 1,95,100 |

**Notes to Accounts**

| | | ₹ | ₹ |
|---|---|---|---|
| 1 | Revenue from Operations | | |
| | X Ltd. | 18,00,000 | |
| | Y Ltd. | 19,00,000 | |
| | Total | 37,00,000 | |
| | *Less*: Intra-group sales (X sold to Y) | (1,20,000) | 35,80,000 |
| 2 | Cost of Materials Purchased/Consumed | | |
| | X Ltd. | 10,00,000 | |
| | Y Ltd. | 12,00,000 | |
| | Total | 22,00,000 | |
| | *Less:* Intra-group sales (X sold to Y) | (1,20,000) | 20,80,000 |
| 3 | Employee benefit and expenses | | |
| | Wages and salaries | | |
| | H Ltd. | 2,00,000 | |
| | S Ltd. | 3,00,000 | 5,00,000 |
| 4 | Finance cost | | |
| | Interest | | |
| | H Ltd. | 24,000 | |
| | S Ltd. | 24,000 | 48,000 |
| 5 | Depreciation | | |
| | H Ltd. | 2,20,000 | |
| | S Ltd. | 2,37,000 | 4,57,000 |

| | | ₹ | ₹ |
|---|---|---|---|
| 6 | Other expenses | | |
| | H Ltd. | 1,60,000 | |
| | S Ltd. | 1,20,000 | 2,80,000 |

**Working Note**

**1. Profit of Subsidiary** ₹

| | | |
|---|---|---|
| Revenue from Operations | | 19,00,000 |
| *Less*: Expenses | | |
| Cost of Material purchased/Consumed | 12,00,000 | |
| Changes of Inventories of finished goods | - | |
| Employee benefit expense | 3,00,000 | |
| Finance cost | 24,000 | |
| Depreciation and amortization expense | 2,37,000 | |
| Other expenses | 1,20,000 | |
| Total expenses | | (18,81,000) |
| Profit Before Tax | | 19,000 |
| *Less:* Preference Dividend | 14,000 | |
| *Less:* Preference Dividend Payable | 14,000 | (28,000) |
| Profit available for shareholders | | (9,000) |
| Minority Share (20% of loss ₹ 9,000) | | (1,800) |

2. **Inventory reserve** $= \left[\frac{120{,}000}{4} \times \frac{25}{125}\right] =$₹ 6,000

3. **Pre-acquisition loss** = 80% of 3 month's profit up to 30th June,2020 i.e. 80 % of ¼ of loss ₹ 9,000. Hence, pre-acquisition loss = ₹ 1,800

4. Investment account includes Preference dividend for 3 months prior to acquisition i.e. ₹ 4,00,000 X 50% X 7% X1/4 = ₹ 3,500

## Question 74

Long Limited acquired 60% stake in Short Limited for a consideration of ₹ 112 lakhs. On the date of acquisition Short Limited's Equity Share Capital was ₹ 100 lakhs, Revenue Reserve was ₹ 40 lakhs and balance in Profit & Loss Account was ₹ 30 lakhs. From the above information you are required to calculate Goodwill / Capital Reserve in the following situations:

(i) On consolidation of Balance Sheet.

(ii) If Long Limited showed the investment in subsidiary at a carrying amount of ₹ 104 lakhs.

(iii) If the consideration paid for acquiring the 60% stake was ₹ 92 lakhs.

(*July, 2021 Suggested*) (*5 Marks*)

**Answer**

| | ₹ |
|---|---|
| 60% of the Equity Share Capital ₹ 100 Lakhs | 60 |
| 60% of Accumulated Reserve ₹ 70 Lakhs (40+30) Lakhs | 42 |
| Book value of shares of Short Ltd. | 102 |

(i) Goodwill/Capital Reserve computation on consolidation of balance sheet
Long Ltd. paid a positive differential of ₹ 10 Lakhs (112 - 102). This differential ₹ 10 Lakhs is called goodwill and is shown in the balance sheet under the head intangibles

(ii) If Long Ltd. showed the investment in Short Ltd. at carrying amount of ₹ 104 Lakhs, then the goodwill will be ₹ 2 Lakhs.

If the consideration paid is ₹ 92 lakhs, then there would have been capital reserve amounting ₹ 10 Lakhs (102- 92).

## Question 75

Consider the following information of subsidiary MNT Ltd.-

| Liabilities | 2019-20 | 2020-21 |
|---|---|---|
| | Amount in ₹ | Amount in ₹ |
| Issued and subscribed: 7,500 Equity Shares of ₹ 100 each | 7,50,000 | 7,50,000 |
| Revenue Reserve | 2,14,000 | 5,05,000 |
| Securities Premium | 72,000 | 2,07,000 |
| Trade Payables | 2,90,000 | 2,46,000 |
| Bank Overdraft | - | 1,70,000 |

| Liabilities | 2019-20 | 2020-21 |
|---|---|---|
| Provision for Taxation | 2,62,000 | 4,30,000 |
| Property, plant and equipment (Cost) | 9,20,000 | 9,20,000 |
| Less: Accumulated Depreciation | (1,70,000) | (2,82,500) |
| | 7,50,000 | 6,37,500 |
| Investment (at cost) | - | 5,30,000 |
| Inventory | 4,12,300 | 6,90,000 |
| Trade Receivable | 2,95,000 | 3,43,000 |
| Prepaid expenses | 78,000 | 65,000 |
| Cash at Bank | 52,700 | 42,500 |

Other Information:

(1) MNT Ltd. is a subsidiary of LTC Ltd.

(2) LTC Ltd. values inventory on FIFO basis, while MNT Ltd. used LIFO basis. To bring MNT Ltd.'s inventories values in line with those of LTC Ltd., its value of inventory is required to be reduced by ₹ 5,000 at the end of 2019-2020 and increased by ₹ 12,000 at the end of 2020- 2021. (Inventory of 2019-20 has been sold out during the year 2020-21)

(3) MNT Ltd. deducts 2% from Trade Receivables as a general provision against doubtful debts.

(4) Prepaid expenses in MNT Ltd. include Sales Promotion expenditure carried forward of ₹ 25,000 in 2019-20 and ₹ 12,500 in 2020-21 being part of initial Sales Promotion expenditure of ₹ 37,500 in 2019-20, which is being written off over three years. Similar nature of Sales Promotion expenditure of LTC Ltd. has been fully written off in 2019-20.

Restate the balance sheet of MNT Ltd. as on 31st March, 2021 after considering the above information for the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by LTC Ltd. and MNT Ltd. uniform.

(*MTP*, *October 2021*) (*16 Marks*)

**Answer**

**Restated Balance Sheet of MNT Ltd. as at 31st March 2021**

| Particulars | Note No. | (₹) |
|---|---|---|
| I. Equity and Liabilities | | |
| (1) Shareholder's Funds | | |
| (a) Share Capital | | 7,50,000 |
| (b) Reserves and Surplus | 1 | 7,18,500 |
| (2) Current Liabilities | | |
| (a) Short term borrowings | 2 | 1,70,000 |
| (b) Trade Payables | | 2,46,000 |
| (c) Short-term provision | 3 | 4,30,000 |
| Total | | 23,14,500 |
| II. Assets | | |
| (1) Non-current assets | | |
| (a) Property, Plant & Equipment | 4 | 6,37,500 |
| (b) Non-current Investment | | 5,30,000 |
| (2) Current assets | | |
| (a) Inventories (6,90,000 +12,000) | 5 | 7,02,000 |
| (b) Trade Receivables $\left(\frac{3,43,000}{98}\times 100\right)$ | | 3,50,000 |
| (c) Cash & Cash Equivalents | | 42,500 |
| (d) Other current assets | 6 | 52,500 |
| Total | | 23,14,500 |

**Notes to Accounts**

| | | | ₹ |
|---|---|---|---|
| 1. | Reserves and Surplus | | |
| | Revenue Reserve (refer W.N.) | 5,11,500 | |
| | Securities Premium | 2,07,000 | 7,18,500 |
| 2. | **Short term borrowings** | | |
| | Bank overdraft | | 1,70,000 |
| 3. | Short-term provision | | |
| | Provision for taxation | | 4,30,000 |

| | | | ₹ |
|---|---|---|---|
| 4. | Property, Plant and Equipment | | |
| | Cost | 9,20,000 | |
| | *Less*: Depreciation to date | (2,82,500) | 6,37,500 |
| 5. | **Inventories** | 6,90,000 | |
| | Increase in value as per FIFO | 12,000 | 7,02,000 |
| 6. | **Other current assets** | | |
| | Prepaid expenses (After adjusting sales promotion expenses to be written off each year) (65,000 -12,500) | | 52,500 |

**Working Note:**

**Adjusted revenue reserves of MNT Ltd.:**

| | ₹ | ₹ |
|---|---|---|
| Revenue reserves as given | | 5,05,000 |
| *Add:* Provision for doubtful debts [3,43,000 X 2/98) | 7,000 | |
| *Add:* Increase in value of inventory | 12,000 | 19,000 |
| | | 5,24,000 |
| *Less:* Sales Promotion expenditure to be written off | | (12,500) |
| Adjusted revenue reserve | | 5,11,500 |

## Question 76

A Ltd. had acquired 80% shares of B Ltd. for ₹ 15 lakhs at the beginning of year. During the year, A Ltd. sold the investment for ₹ 30 lakhs and net assets of B Ltd. on the date of disposal was ₹ 35 lakhs. Calculate the profit or loss on disposal of this investment to be recognized in the Financial Statements of A Ltd.

(*MTP*, *October 2021*) (*4 Marks*)

**Answer**

**Calculation of Profit/Loss on disposal of investment in subsidiary**

| ***Particulars*** | ₹ |
|---|---|
| Proceeds from the sale of Investment | 30,00,000 |
| *Less*: A Ltd.'s share in net assets of B Ltd. | (28,00,000) |
| | 2,00,000 |

**Working Note:**

**A Ltd.'s share in net assets of B Ltd.**

| | ₹ |
|---|---|
| Net Assets of B Ltd. on the date of disposal | 35,00,000 |
| *Less*: Minority Interest (20% of ₹ 35 lakhs) | (7,00,000) |
| A Ltd.'s share in the net assets of B Ltd. | 28,00,000 |

## Question 77

On 31st March, 2020 H Ltd. and its subsidiary S Ltd. give the following information:

| | **H Ltd.** | **S Ltd.** |
|---|---|---|
| | ₹ | ₹ |
| Shareholders' Fund: | | |
| Equity shares of ₹ 10 each | 13,40,000 | 2,40,000 |
| Reserves and Surplus | 4,80,000 | 1,80,000 |
| Profit & Loss Account | 2,40,000 | 60,000 |
| Secured Loans: | | |
| 12% Debentures | 1,00,000 | - |
| Current Liabilities: | | |
| Creditors | 2,00,000 | 1,22,000 |
| Bank Overdraft | 1,00,000 | - |
| Bills Payable | 60,000 | 14,800 |
| Property, Plant & Equipment: | | |
| Machinery | 7,20,000 | 2,16,000 |
| Furniture | 3,60,000 | 40,800 |
| Investments: | | |
| Investments in S Ltd. | 3,84,000 | - |
| (19,200 shares at ₹ 20 each) | | |

| | H Ltd. | S Ltd. |
|---|---|---|
| | ₹ | ₹ |
| Current Assets: | | |
| Inventories | 6,00,000 | 2,00,000 |
| Trade Receivables | 3,00,000 | 90,000 |
| Bill Receivables | 1,00,000 | 30,000 |
| Cash at Bank | 56,000 | 40,000 |

The following information is also provided to you:

(a) H Ltd. purchased 19,200 shares of S Ltd. on 1st April, 2019, when the balances of Reserves & Surplus and Profit & Loss Account of S Ltd. stood at ₹ 60,000 and ₹ 36,000 respectively.

(b) Machinery (Book value ₹ 2,40,000) and Furniture (Book value ₹ 48,000) of S Ltd were revalued at ₹ 3,60,000 and ₹ 36,000 respectively on 1st April, 2019, for the purpose of fixing the price of its shares. (Rates of depreciation computed on the basis of useful lives:
Machinery 10%, Furniture 15%).

(c) On 31st March, 2020, Bills payable of ₹ 12,000 shown in S Ltd.'s Balance Sheet had been accepted in favour of H Ltd.

You are required to prepare Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2020.

(*MTP, November, 2021*) (*20 Marks*)

**Answer**

**Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2020**

| Particulars | Note No. | (₹) |
|---|---|---|
| I. Equity and Liabilities | | |
| (1) Shareholder's Funds | | |
| (a) Share Capital | 1 | 13,40,000 |
| (b) Reserves and Surplus | 2 | 8,27,040 |
| (2) Minority Interest | | 1,15,560 |
| (3) Non- Current Liabilities | | |
| **(a)** 12% Debentures | | 1,00,000 |
| (4) Current Liabilities | | |
| (a) Trade Payables | 3 | 3,84,800 |
| (b) Short term Borrowings (Bank overdraft) | | 1,00,000 |
| Total | | 28,67,400 |
| II. Assets | | |
| (1) Non-current assets | | |
| (a) | | |
| (i) Property, Plant and Equipment | 4 | 14,34,600 |
| (ii) Intangible assets | 5 | 28,800 |
| (2) Current assets | | |
| (a) Inventory (6,00,000+2,00,000) | | 8,00,000 |
| (b) Trade Receivables | 6 | 5,08,000 |
| (c) Cash and Cash equivalents | | 96,000 |
| Total | | 28,67,400 |

**Notes to Accounts**

| | | ₹ | | |
|---|---|---|---|---|
| 1. | Share Capital Equity share capital 1,34,000 shares of ₹ 10 each fully paid up | | | 13,40,000 |
| 2. | Reserves and Surplus | | | |
| | Reserves | | 4,80,000 | |
| | *Add:* 4/5th share of S Ltd.'s post- acquisition reserves (W.N.3) | | 96,000 | 5,76,000 |
| | Profit and Loss Account | | 2,40,000 | |
| | *Add:* 4/5th share of S Ltd.'s post- acquisition profits (W.N.4) | | 11,040 | 2,51,040 |
| | | | | 8,27,040 |
| 3. | Trade Payables | | | |
| | Creditors | | | |

| | | ₹ | | |
|---|---|---|---|---|
| | H Ltd. | 2,00,000 | | |
| | S Ltd. | 1,22,000 | 3,22,000 | |
| | Bills Payables | | | |
| | H Ltd. | 60,000 | | |
| | S Ltd. | 14,800 | 74,800 | |
| | | | 3,96,800 | |
| | Less: Mutual Owings | | (12,000) | 3,84,800 |
| 4. | Property Plant and Equipment | | | |
| | Machinery | | | |
| | H. Ltd. | | 7,20,000 | |
| | S Ltd. | 2,40,000 | | |
| | Add: Appreciation | 1,20,000 | | |
| | | 3,60,000 | | |
| | Less: Depreciation (3,60,000 X 10%) | (36,000) | 3,24,000 | |
| | Furniture | | | |
| | H. Ltd. | | 3,60,000 | |
| | S Ltd. | 48,000 | | |
| | Less: Decrease in value | (12,000) | | |
| | | 36,000 | | |
| | Less: Depreciation (36,000 X 15%) | 5,400 | 30,600 | 14,34,600 |
| 5. | Intangible assets | | | |
| | Goodwill [WN 6] | | | 28,800 |
| 6. | Trade receivables | | | |
| | H Ltd. | 3,00,000 | | |
| | S Ltd. | 90,000 | 3,90,000 | |
| | Bills Receivables | | | |
| | H Ltd. | 1,00,000 | | |
| | S Ltd. | 30,000 | 1,30,000 | |
| | | | 5,20,000 | |
| | Less: Mutual Owings | | (12,000) | 5,08,000 |

**Working Notes:**

| | | ₹ |
|---|---|---|
| 1. | Pre-acquisition profits and reserves of S Ltd. | |
| | Reserves | 60,000 |
| | Profit and Loss Account | 36,000 |
| | | 96,000 |
| | H Ltd.'s = 4/5 (or 80%) × 96,000 | 76,800 |
| | Minority Interest= 1/5 (or 20%) × 96,000 | 19,200 |
| 2. | Profit on revaluation of assets of S Ltd. | |
| | Profit on Machinery ₹ (3,60,000 – 2,40,000) | 1,20,000 |
| | *Less*: Loss on Furniture ₹(48,000 –36,000) | (12,000) |
| | Net Profit on revaluation | 1,08,000 |
| | H Ltd.'s share 4/5 × 1,08,000 | 86,400 |
| | Minority Interest 1/5 × 1,08,000 | 21,600 |
| 3. | Post-acquisition reserves of S Ltd. | |
| | Total reserves | 1,80,000 |
| | Less: Pre-acquisition reserves | (60,000) |
| | Post-acquisition reserves | 1,20,000 |
| | H Ltd.'s share 4/5 × 1,20,000 | 96,000 |
| | Minority interest 1/5 × 1,20,000 | 24,000 |
| 4. | Post -acquisition profits of S Ltd. | |
| | Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = ₹ 60,000 – 36,000) | 24,000 |

| | | | |
|---|---|---|---|
| | *Add:* Excess depreciation charged on furniture @ 15% | | |
| | on ₹ 12,000 i.e. (48,000 – 36,000) | | 1,800 |
| | *Less*: Under depreciation on machinery @ 10% | | 25,800 |
| | on ₹ 1,20,000 i.e. (3,60,000 – 2,40,000) | | (12,000) |
| | Adjusted post-acquisition profits | | 13,800 |
| | H Ltd.'s share 4/5 × 13,800 | | 11,040 |
| | Minority Interest 1/5 × 13,800 | | 2,760 |
| 5. | Minority Interest | | |
| | Paid-up value of (24,000 – 19,200) = 4,800 shares | | |
| | held by outsiders i.e. 2,40,000 X 20% | | 48,000 |
| | *Add:* 1/5th share of pre-acquisition profits and reserves | | 19,200 |
| | 1/5th share of profit on revaluation | | 21,600 |
| | 1/5th share of post-acquisition reserves | | 24,000 |
| | 1/5th share of post-acquisition profit | | 2,760 |
| | | | 1,15,560 |
| 6. | Cost of Control or Goodwill | | |
| | Price paid by H Ltd. for 19,200 shares | (A) | 3,84,000 |
| | *Less:* Intrinsic value of the shares | | 1,92,000 |
| | Paid-up value of shares held by H Ltd. i.e. 2,40,000 X 80% | | |
| | *Add:* 4/5th share of pre-acquisition profits and reserves | | 76,800 |
| | 4/5th share of profit on the revaluation | | 86,400 |
| | Intrinsic value of shares on the date of acquisition | (B) | 3,55,200 |
| | Cost of control or Goodwill | (B-A) | 28,800 |

## Question 78

On 31st March, 2015, P Ltd. acquired 1,05,000 shares of Q Ltd. for ₹ 12,00,000. The position of Q Ltd. on that date was as under:

| | ₹ |
|---|---|
| Property, plant and equipment | 10,50,000 |
| Current Assets | 6,45,000 |
| 1,50,000 equity shares of ₹ 10 each fully paid | 15,00,000 |
| Pre-incorporation profits | 30,000 |
| Profit and Loss Account | 60,000 |
| Trade payables | 1,05,000 |

P Ltd. and Q Ltd. give the following information on 31st March, 2021:

| | P Ltd.<br>₹ | Q Ltd.<br>₹ |
|---|---|---|
| Equity shares of ₹ 10 each fully paid (before bonus issue) | 45,00,000 | 15,00,000 |
| Securities Premium | 9,00,000 | – |
| Pre-incorporation profits | – | 30,000 |
| General Reserve | 60,00,000 | 19,05,000 |
| Profit and Loss Account | 15,75,000 | 4,20,000 |
| Trade payables | 5,55,000 | 2,10,000 |
| Property, plant and equipment | 79,20,000 | 23,10,000 |
| Investment: 1,05,000 Equity shares in Q Ltd. at cost | 12,00,000 | – |
| Current Assets | 44,10,000 | 17,55,000 |

Directors of Q Ltd. made bonus issue on 31.3.2021 in the ratio of one equity share of ₹ 10 each fully paid for every two equity shares held on that date. Bonus shares were issued out of post-acquisition profits by using General Reserve.

Calculate as on 31st March, 2021 (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (ii) Consolidated Profit and Loss Account in each of the following cases:

(a) Before issue of bonus shares.

(b) Immediately after issue of bonus shares.

(*RTP November 2021*)

**Answer**

**Shareholding pattern**

| Particulars | Number of Shares | % of holding |
|---|---|---|
| (a) P Ltd. | | |
| (i) Purchased on 31.03.2015 | 1,05,000 | |
| (ii) Bonus Issue (1,05,000/2) | 52,500 | |
| Total | 1,57,500 | 70% |
| (b) Minority Interest | 67,500 | 30% |

**Calculations of (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account as on 31st March, 2021:**

**(a) Before issue of bonus shares**

| | | | |
|---|---|---|---|
| **(i)** | **Cost of control/capital reserve** | **₹** | **₹** |
| | Investment in Q Ltd. | | 12,00,000 |
| | Less: Face value of investments | 10,50,000 | |
| | Capital profits (W.N.) | 63,000 | (11,13,000) |
| | Cost of control | | 87,000 |
| **(ii)** | **Minority Interest** | | **₹** |
| | Share Capital | | 4,50,000 |
| | Capital profits (W.N.) | | 27,000 |
| | Revenue profits (W.N.) | | 6,79,500 |
| | | | 11,56,500 |
| **(iii)** | **Consolidated profit and loss account – P Ltd.** | | **₹** |
| | Balance | | 15,75,000 |
| | Add: Share in revenue profits of Q Ltd. (W.N.) | | 15,85,500 |
| | | | 31,60,500 |

**(b) Immediately after issue of bonus shares**

| | | | |
|---|---|---|---|
| **(i)** | **Cost of control/capital reserve** | **₹** | **₹** |
| | Face value of investments (₹ 10,50,000 + ₹ 5,25,000) | 15,75,000 | |
| | Capital Profits (W.N.) | 63,000 | 16,38,000 |
| | Less: Investment in Q Ltd. | | (12,00,000) |
| | Capital reserve | | 4,38,000 |
| **(ii)** | **Minority Interest** | | **₹** |
| | Share Capital (₹ 4,50,000 + ₹ 2,25,000) | | 6,75,000 |
| | Capital Profits (W.N.) | | 27,000 |
| | Revenue Profits (W.N.) | | 4,54,500 |
| | | | 11,56,500 |
| **(iii)** | **Consolidated Profit and Loss Account – P Ltd.** | | **₹** |
| | Balance | | 15,75,000 |
| | Add: Share in revenue profits of Q Ltd. (W.N.) | | 10,60,500 |
| | | | 26,35,500 |

**Working Note:**

**Analysis of Profits of Q Ltd.**

| | Capital Profits | Revenue Profits | |
|---|---|---|---|
| | (Before and after issue of bonus shares) ₹ | Before Bonus Issue ₹ | After Bonus Issue ₹ |
| Pre-incorporation profits | 30,000 | | |
| Profit and loss account on 31.3.2015 | 60,000 | | |
| General reserve* | 90,000 | | 19,05,000 |
| Less: Bonus shares | | 19,05,000 | (7,50,000) |
| | | | 11,55,000 |

| | | | |
|---|---|---|---|
| Profit for period of 1st April, 2015 to 31st March, 2021 (₹ 4,20,000 – ₹ 60,000) | | 3,60,000 | 3,60,000 |
| | | 22,65,000 | 15,15,000 |
| P Ltd.'s share (70%) | 63,000 | 15,85,500 | 10,60,500 |
| Minority's share (30%) | 27,000 | 6,79,500 | 4,54,500 |

*Share of P Ltd. in General reserve has been adjusted in Consolidated Profit and Loss Account.

## Question 79

From the following information of Beta Ltd. and its subsidiary Gamma Ltd. drawn up at 31st March, 2021, prepare a consolidated balance sheet as at that date:

| | Beta Ltd. | Gamma Ltd. |
|---|---|---|
| | ₹ | ₹ |
| Share Capital: | | |
| Shares of ₹ 100 each | 15,00,000 | 2,50,000 |
| Reserves | 5,00,000 | 1,87,500 |
| Profit and Loss Account | 2,50,000 | 62,500 |
| Trade Payables | 3,75,000 | 1,42,500 |
| Property, plant and Equipment: | | |
| Machinery | 7,50,000 | 2,25,000 |
| Furniture | 3,75,000 | 42,500 |
| Other non-current assets | 11,00,000 | 3,75,000 |
| Non-current Investments: | | |
| Shares in Gamma Ltd.: 2,000 shares at ₹ 200 each | 4,00,000 | |

Other information:

Reserves and Profit and Loss Account of Gamma Ltd. stood at ₹ 62,500 and ₹ 37,500 respectively on the date of acquisition of its 80% shares by Beta Ltd. on 1st April, 2020.

Machinery (Book-value ₹ 2,50,000) and Furniture (Book value ₹ 50,000) of Gamma Ltd. were revalued at ₹ 3,75,000 and ₹ 37,500 respectively on 1st April, 2020 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.]

(*RTP May, 2022*)

**Answer**

**Consolidated Balance Sheet of Beta Ltd. and its Subsidiary Gamma Ltd. as at 31st March, 2021**

| Particulars | Note No. | (₹) |
|---|---|---|
| **I. Equity and Liabilities** | | |
| **(1) Shareholder's Funds** | | |
| (a) Share Capital | | 15,00,000 |
| (b) Reserves and Surplus | 1 | 8,61,500 |
| **(2) Minority Interest** (W.N.5) | | 1,20,375 |
| **(3) Current Liabilities** | | |
| (a) Trade Payables | 2 | 5,17,500 |
| **Total** | | 29,99,375 |
| **II. Assets** | | |
| **(1) Non-current assets** | | |
| (a) (i) Property, Plant & Equipment | 3 | 14,94,375 |
| (ii) Intangible assets | 4 | 30,000 |
| (b) Other non- current assets | 5 | 14,75,000 |
| **Total** | | 29,99,375 |

**Notes to Accounts**

| | | ₹ | | |
|---|---|---|---|---|
| 1. | **Reserves and Surplus** | | | |
| | Reserves | | 5,00,000 | |
| | *Add:* 4/5th share of Gamma Ltd.'s post- acquisition reserves (W.N.3) | | 1,00,000 | 6,00,000 |
| | Profit and Loss Account | | 2,50,000 | |
| | *Add:* 4/5th share of Gamma Ltd.'s post- acquisition profits (W.N.4) | | 11,500 | 2,61,500 |
| | | | | 8,61,500 |

| | | ₹ | | |
|---|---|---|---|---|
| **2.** | **Trade Payables** | | | |
| | Beta Ltd. | | 3,75,000 | |
| | Gamma Ltd. | | 1,42,500 | 5,17,500 |
| **3.** | **Property, Plant & Equipment** | | | |
| | Machinery | | | |
| | Beta Ltd. | | 7,50,000 | |
| | Gamma Ltd. | 2,50,000 | | |
| | *Add:* Appreciation | 1,25,000 | | |
| | | 3,75,000 | | |
| | *Less:* Depreciation | (37,500) | 3,37,500 | |
| | Furniture | | | |
| | Beta Ltd. | | 3,75,000 | |
| | Gamma Ltd. | 50,000 | | |
| | *Less:* Decrease in value | (12,500) | | |
| | | 37,500 | | |
| | *Less*: Depreciation | (5,625) | 31,875 | 14,94,37 |
| **4.** | **Intangible assets** | | | |
| | Goodwill [WN 6] | | | 30,000 |
| **5.** | **Other non-current assets** | | | |
| | Beta Ltd. | | 11,00,000 | |
| | Gamma Ltd. | | 3,75,000 | 14,75,00 |

**Working Notes:**

| | | |
|---|---|---|
| **1.** | **Pre-acquisition profits and reserves of Gamma Ltd.** | ₹ |
| | Reserves | 62,500 |
| | Profit and Loss Account | 37,500 |
| | | 1,00,000 |
| | Beta Ltd.'s = 4/5 × 1,00,000 | 80,000 |
| | Minority Interest = 1/5 × 1,00,000 | 20,000 |
| **2.** | **Profit on revaluation of assets of Gamma Ltd.** | |
| | Profit on Machinery ₹ (3,75,000 – 2,50,000) | 1,25,000 |
| | *Less*: Loss on Furniture ₹ (50,000 – 37,500) | 12,500 |
| | Net Profit on revaluation | 1,12,500 |
| | Beta Ltd.'s share 4/5 × 1,12,500 | 90,000 |
| | Minority Interest 1/5 × 1,12,500 | 22,500 |
| **3.** | **Post-acquisition reserves of Gamma Ltd.** | |
| | Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 1,87,500 – 62,500) | 1,25,000 |
| | Beta Ltd.'s share 4/5 × 1,25,000 | 1,00,000 |
| | Minority interest 1/5 × 25,000 | 25,000 |
| **4.** | **Post -acquisition profits of Gamma Ltd.** | |
| | Post-acquisition profits (Profit & loss account balance less pre- acquisition profits = ₹ 62,500 – 37,500) | 25,000 |
| | *Add:* Excess depreciation charged on furniture @ 15% | |
| | on ₹ 12,500 i.e. (50,000 – 37,500) | 1,875 |
| | *Less*: Under depreciation on machinery @ 10% | 26,875 |
| | on ₹ 1,25,000 i.e. (3,75,000 – 2,50,000) | (12,500) |
| | Adjusted post-acquisition profits | 14,375 |
| | Beta Ltd.'s share 4/5 × 14,375 | 11,500 |
| | Minority Interest 1/5 × 14,375 | 2,875 |
| **5.** | **Minority Interest** | |
| | Paid-up value of (2,500 – 2,000) = 500 shares | |
| | held by outsiders i.e. 500 × ₹ 100 | 50,000 |
| | *Add:* 1/5th share of pre-acquisition profits and reserves | 20,000 |
| | 1/5th share of profit on revaluation | 22,500 |

| | |
|---|---|
| 1/5th share of post-acquisition reserves | 25,000 |
| 1/5th share of post-acquisition profit | 2,875 |
| | 1,20,375 |
| **6. Cost of Control or Goodwill** | |
| Paid-up value of 2,000 shares held by Beta Ltd. i.e. 2,000 × ₹ 100 | 2,00,000 |
| *Add:* 4/5th share of pre-acquisition profits and reserves | 80,000 |
| 4/5th share of profit on the revaluation | 90,000 |
| Intrinsic value of shares on the date of acquisition | 3,70,000 |
| Price paid by Beta Ltd. for 2,000 shares | 4,00,000 |
| *Less:* Intrinsic value of the shares | (3,70,000) |
| Cost of control or Goodwill | 30,000 |

## Question 80

Moon Ltd. and its subsidiary Star Ltd. provided the following information for the year ended 31st March, 2021.

| Particulars | Moon Ltd. (₹) | Star Ltd. (₹) |
|---|---|---|
| Equity Share Capital | 20,000,000 | 6,000,000 |
| Finished Goods Inventory as on 01.04.2020 | 4,200,000 | 3,010,000 |
| Finished Goods Inventory as on 31.03.2021 | 8,575,000 | 3,762,500 |
| Dividend Income | 1,680,000 | 437,500 |
| Other non-operating Income | 350,000 | 105,000 |
| Raw material consumed | 13,930,000 | 4,725,000 |
| Selling and Distribution Expenses | 3,325,000 | 1,575,000 |
| Production Expenses | 3,150,000 | 1,400,000 |
| Loss on sale of investments | 262,500 | Nil |
| Sales and other operating income | 33,250,000 | 19,075,000 |
| Wages and Salaries | 13,300,000 | 2,450,000 |
| General and Administrative Expenses | 2,800,000 | 1,225,000 |
| Royalty paid | Nil | 50,000 |
| Depreciation | 315,000 | 140,000 |
| Interest expense | 175,000 | 52,500 |

Other information:

- On 1st September, 2018 Moon Ltd. acquired 50,000 equity shares of ₹ 100 each fully paid up in Star Ltd.
- Star Ltd. paid a dividend of 10% for the year ended 31st March, 2020. The dividend was correctly accounted for by Moon Ltd.
- Moon Ltd. sold goods of ₹ 17,50,000 to Star Ltd. at a profit of 20% on selling price. Inventory of Star Ltd. includes goods of ₹ 7,00,000 received from Moon Ltd.
- Selling and Distribution expenses of Star Ltd. include ₹ 2,12,500 paid to Moon Ltd. as brokerage fees.
- General and Administrative expenses of Moon Ltd. include ₹ 2,80,000 paid to Star Ltd. as consultancy fees.
- Star Ltd. used some resources of Moon Ltd., and Star Ltd. paid 1 50,000 to Moon Ltd. as royalty.

Prepare consolidated statement of Profit and Loss of Moon Ltd. and its subsidiary Star Ltd. for the year ended 31.03.2021 as per schedule III of the Companies Act, 2013.

(*Question Paper of December 2021*) *(15 Marks)*

**Answer**

**Consolidated statement of profit and loss of Moon Ltd. and its subsidiary Star Ltd. for the year ended on 31st March, 2021**

| Particulars | Note No. | ₹ |
|---|---|---|
| Revenue from operations | 1 | 5,00,32,500 |
| Other Income | 2 | 23,10,000 |
| Total revenue (I) | | 5,23,42,500 |
| Expenses: | | |
| Cost of material purchased/consumed | 3 | 2,14,55,000 |
| Changes (Increase) in inventories of finished goods | 4 | (49,87,500) |
| Employee benefit expense | 5 | 1,57,50,000 |
| Finance cost | 6 | 2,27,500 |
| Depreciation and amortization expense | 7 | 4,55,000 |
| Other expenses | 8 | 84,32,500 |
| **Total expenses (II)** | | 4,13,32,500 |
| **Profit before tax (II-III)** | | 1,10,10,000 |

**Notes to Accounts:**

| | | | ₹ | ₹ |
|---|---|---|---|---|
| 1. | Revenue from operations | | | |
| | Sales and other operating revenues[1] | | | |
| | Moon Ltd. | | 3,32,50,000 | |
| | Star Ltd. | | 190,75,000 | |
| | | | 523,25,000 | |
| | *Less:* Inter-company sales | | (17,50,000) | |
| | Consultancy fees received by Star Ltd. from Moon Ltd. | | (2,80,000) | |
| | Royalty received by Moon Ltd. from Star Ltd. | | (50,000) | 5,00,32,500 |
| | Brokage received by Moon Ltd. from Star Ltd. | | (2,12,500) | |
| 2. | Other Income | | | |
| | Dividend income: | | | |
| | Moon Ltd. | 16,80,000 | | |
| | Star Ltd. | 4,37,500 | 21,17,500 | |
| | Loss on sale of investments Star Ltd. | | (2,62,500) | |
| | Other Non-operating Income | | | |
| | Moon Ltd. | 3,50,000 | | |
| | Star Ltd. | 1,05,000 | 4,55,000 | 23,10,000 |
| 3. | Cost of material purchased/consumed | | | |
| | Moon Ltd. | 1,39,30,000 | | |
| | Star Ltd. | 47,25,000 | | |
| | | 1,86,55,000 | | |
| | *Less*: Purchases by Star Ltd. From Moon Ltd. | (17,50,000) | 1,69,05,000 | |
| | Direct expenses (Production) | | | |
| | Moon Ltd. | 31,50,000 | | |
| | Star Ltd. | 14,00,000 | 45,50,000 | 2,14,55,000 |
| 4. | Changes (Increase) in inventories of finished goods | | | |
| | Moon Ltd. | | 43,75,000 | |
| | Star Ltd. | | 7,52,500 | |
| | | | 51,27,500 | |
| | *Less:* Unrealized profits ₹ 7,00,000 × 20/100 | | (1,40,000) | 49,87,500 |
| 5. | Employee benefits and expenses | | | |
| | Wages and salaries: | | | |
| | Moon Ltd. | | 1,33,00,000 | |
| | Star Ltd. | | 24,50,000 | 1,57,50,000 |
| 6 | Finance cost | | | |
| | Interest: | | | |
| | Moon Ltd. | | 1,75,000 | |
| | Star Ltd. | | 52,500 | 2,27,500 |
| 7. | Depreciation | | | |
| | Moon Ltd. | | 3,15,000 | |
| | Star Ltd. | | 1,40,000 | 4,55,000 |
| 8. | Other expenses | | | |
| | General & Administrative expenses: | | | |
| | Moon Ltd. | 28,00,000 | | |
| | Star Ltd. | 12,25,000 | | |
| | | 40,25,000 | | |
| | *Less*: Consultancy fees received by Star Ltd. from Moon Ltd. | (280,000) | 37,45,000 | |

**1** *Consultancy fees, Royalty and brokerage received are considered as operating revenues in the given answer.*

| | | | ₹ | ₹ |
|---|---|---|---|---|
| | Royalty: | | | |
| | Star Ltd. | 50,000 | | |
| | Less: Received by Moon Ltd. | (50,000) | Nil | |
| | Selling and distribution Expenses: | | | |
| | Moon Ltd. | 33,25,000 | | |
| | Star Ltd. | 15,75,000 | | |
| | | 49,00,000 | | |
| | *Less*: Brokerage received by Moon Ltd. from Star Ltd. | (2,12,500) | 46,87,500 | 84,32,500 |

## Question 81

On 31st March, 2022, H Ltd. and S Ltd. give the following information:

| | H Ltd. (₹ in 000's) | S Ltd. (₹ in 000's) |
|---|---|---|
| Equity Share Capital – Authorised | 5,000 | 3,000 |
| Issued and subscribed in Equity Shares of ₹ 10 each fully paid | 4,000 | 2,400 |
| General Reserve | 928 | 690 |
| Profit and Loss Account (Cr. Balance) | 1,305 | 810 |
| Trade payables | 611 | 507 |
| Provision for Taxation | 220 | 180 |
| Other Provisions | 65 | 17 |
| Plant and Machinery | 2,541 | 2,450 |
| Furniture and Fittings | 615 | 298 |
| Investment in the Equity Shares of S Ltd. | 1,500 | — |
| Inventory | 983 | 786 |
| Trade receivables | 820 | 778 |
| Cash and Bank Balances | 410 | 102 |
| Sundry Advances (Dr. balances) | 260 | 190 |

Following Additional Information is available:

(a) H Ltd. purchased 90 thousand Equity Shares in S Ltd. on 1st April, 2021 at which date the following balances stood in the books of S Ltd.:

General Reserve ₹ 1,500 thousand; Profit and Loss Account ₹ 633 thousand.

(b) On 14th July, 2021 S Ltd. declared a dividend of 20% out of pre-acquisition profits. H Ltd. credited the dividend received to its Profit and Loss Account.

(c) On 1st November, 2021, S Ltd. issued 3 fully paid Equity Shares of ₹ 10 each, for every 5 shares held as bonus shares out of pre-acquisition General Reserve.

(d) On 31st March, 2021, the Inventory of S Ltd. included goods purchased for ₹ 50 thousand from H Ltd., which had made a profit of 25% on cost.

(e) Details of Trade payables and Trade receivables:

| | H Ltd. (₹ in 000's) | S Ltd. (₹ in 000's) |
|---|---|---|
| Trade payables | | |
| Bills Payable | 124 | 80 |
| Sundry creditors | 487 | 427 |
| | 611 | 507 |
| Trade receivables | | |
| Debtors | 700 | 683 |
| Bills Receivables | 120 | 95 |
| | 820 | 778 |

Prepare a consolidated Balance Sheet as on 31st March, 2022.

(*RTP November, 2022*)

**Answer**

**Consolidated Balance Sheet of H Ltd. with its subsidiary S Ltd. as at 31st March, 2022**

| ***Particulars*** | ***Note No.*** | ***(₹ in 000's)*** |
|---|---|---|
| I. Equity and Liabilities | | |
| (1) Shareholder's Funds | | |
| (a) Share Capital | 1 | 4,000 |
| (b) Reserves and Surplus | 2 | 3,063 |

| ***Particulars*** | ***Note No.*** | ***(₹ in 000's)*** |
|---|---|---|
| (2) Minority Interest (W.N.6) | | 1,560 |
| (3) Current Liabilities | | |
| Trade payables | 3 | 1,118 |
| Short term provisions | 4 | 482 |
| Total | | 10,223 |
| II. Assets | | |
| (1) Non-current assets | | |
| PPE | 5 | 5,904 |
| (2) Current assets | | |
| (a) Inventories | 6 | 1,759 |
| (b) Trade receivables | 7 | 1,598 |
| (c) Cash and cash equivalents | 8 | 512 |
| (d) Short term loans and advances | 9 | 450 |
| Total | | 10,223 |

**Notes to Accounts**

| | | | ***(₹ in 000's)*** | ***(₹ in 000's)*** |
|---|---|---|---|---|
| 1. | Share Capital | | | |
| | Authorised share capital | | | |
| | 5 lakhs equity shares of ₹ 10 each | | | 5,000 |
| | Issued, Subscribed and Paid up | | | |
| | 4 lakhs equity shares of ₹ 10 each fully paid | | | 4,000 |
| 2. | Reserves and surplus | | | |
| | Capital Reserve (Note 5) | | 679.8 | |
| | General Reserve | | 928 | |
| | Profit and Loss Account: | | | |
| | H Ltd. | ₹ 1,305 | | |
| | Add: Share in S Ltd | ₹ 340.20 | | |
| | | ₹ 1,645.20 | | |
| | Less: Dividend wrongly credited | ₹ (180) | | |
| | | ₹ 1,465.20 | | |
| | Less: Unrealised profit (50 X 1/5) | ₹ (10) | 1,455.20 | 3,063 |
| 3. | Trade payables | | | |
| | H Ltd. | | 611 | |
| | S Ltd. | | 507 | 1,118 |
| 4. | Short –term provisions | | | |
| | Provision for Taxation H Ltd. | ₹ 220 | | |
| | S Ltd. | ₹ 180 | 400 | |
| | Other Provisions H Ltd | ₹65 | | |
| | S Ltd. | | 82 | 482 |
| 5. | PPE | | | |
| | Plant and Machinery | | | |
| | H Ltd. | ₹ 2,541 | | |
| | S Ltd. | ₹ 2,450 | 4,991 | |
| | Furniture and fittings | | | |
| | H Ltd. | ₹615 | | |
| | S Ltd. | ₹298 | 913 | 5,904 |
| 6. | Inventories | | | |
| | Inventory H Ltd. | ₹983 | | |
| | S Ltd. | ₹786 | 1,769 | |
| | *Less*: Unrealised profit (₹ 50 x 1/5) | | (10) | 1,759 |
| 7. | Trade receivables | | | |
| | H Ltd. | | 820 | |
| | S Ltd. | | 778 | 1,598 |

| | | **(₹ in 000's)** | **(₹ in 000's)** |
|---|---|---|---|
| 8. | Cash and cash equivalents | | |
| | Cash and Bank Balances | 410 | |
| | H Ltd | | |
| | S Ltd. | 102 | 512 |
| 9. | Short term loans and advances | | |
| | Sundry Advances | 260 | |
| | H Ltd. | | |
| | S Ltd. | 190 | 450 |

**Working Notes:**

**Share holding pattern**

| Particulars | Number of Shares | % of holding |
|---|---|---|
| (a) S Ltd. | | |
| (i) Purchased on 01.04.2021 | 90,000 | |
| (ii) Bonus Issue (90,000/5 x 3) | 54,000 | |
| Total | 1,44,000 | 60% (1,44,000 /2,40,000*x 100) |
| (b) Minority Interest | 96,000 | 40% |

*2,40,000 is after issue of bonus shares as per balance sheet as at 31.3.2022

**1. S Ltd. General Reserve**

| | (₹ in 000) | | (₹ in 000) |
|---|---|---|---|
| To Bonus to equity shareholders $\left(\frac{2,400 \times 3}{8}\right)$ | 900 | By Balance b/d | 1,500 |
| | | By Profit and Loss A/c | |
| To Balance c/d | 690 | (Balancing figure) | 90 |
| | 1,590 | | 1,590 |

**2. S Ltd.'s Profit and Loss Account**

| | (₹ in 000) | | (₹ in 000) |
|---|---|---|---|
| To General Reserve | 90 | By Balance b/d | 633 |
| To Dividend paid on 14.7.2021 $\frac{1,500 \times 20}{100}$ | 300 | By Net Profit for the year (Balancing figure) | 567* |
| To Balance c/d | 810 | | |
| | 1,200 | | 1,200 |

* Out of ₹ 5,67,000 profit for the year, ₹ 90,000 has been transferred to reserves by S Ltd.

**3. Distribution of Revenue Profits**

| | **₹ in '000** |
|---|---|
| Revenue Profit as above | 567.00 |
| Share of H Ltd. (60%) | 340.20 |
| Share of Minority shareholders ( 567– 340.20) | 226.80 |

**4. Computation of Capital Profits**

| | **₹ in 000** | **₹ in 000** |
|---|---|---|
| General Reserve on the date of acquisition | | 1,500 |
| *Less*: Bonus issue of shares | | (900) |
| | | 600 |
| Profit and Loss Account balance on the date of acquisition | 633 | |
| *Less:* Dividends paid | (300) | 333 |
| | | 933 |
| Share of H Ltd. (60%) | | 559.80 |
| Share of Minority shareholders | | 373.20 |

**5. Computation of Capital Reserve**

| | | *₹ in '000* |
|---|---|---|
| 60% of share capital of S Ltd. | | 1,440 |
| *Add:* Share of H Ltd. in the capital profits as in working note (4) | | 559.80 |
| | | 1,999.80 |
| *Less:* Investments in S Ltd. | 1,500 | |
| *Less:* Dividends received out of pre- acquisition profits $\frac{`300 \times 60}{100}$ | (180) | (1,320) |
| | | 679.80 |

**6. Calculation of Minority Interest**

| | ***₹ in '000*** |
|---|---|
| 40% of share capital of S Ltd. | 960.00 |
| *Add:* Share of Revenue Profits (Note 3) | 226.80 |
| Share of Capital Profits (Note 4) | 373.20 |
| | 1,560.00 |

## Question 82

G Ltd. and its subsidiary K Ltd. give the following information for the year ended 31st March, 2023 :

(₹ in crores)

| Particulars | | G Ltd. | K Ltd. |
|---|---|---|---|
| Sales and other Income | | 3000 | 750 |
| Increase in Inventory | | 750 | 100 |
| Raw material consumed' | | 600 | 100 |
| Wages and Salaries | | 600 | 75 |
| Production expenses | | 100 | 50 |
| Administrative expenses | | 75 | 50 |
| Selling-and Distribution expenses | | 100 | 25 |
| Interest | | 75 | 30 |
| Depreciation | | 75 | 30 |

The following information is also given:

(i) G Ltd. sold goods of ₹200 crores to K Ltd. at cost plus 25%. (1/5th of such goods were still in inventory of K Ltd. at the end of the year)

(ii) G Ltd. holds 75% of the Equity share capital of K Ltd. and the Equity share capital of K Ltd. is ₹ 800 crores on 01.04.2022 (date of acquisition of shares )

(iii) Administrative expenses of K Ltd. include ₹ 5 crore paid to G Ltd. as consultancy fees. Also, selling and distribution expenses of G Ltd. include ₹ 20 crores paid to K Ltd. as commission.

Prepare it consolidated statement of Profit and Loss of G Ltd. with its subsidiary K Ltd. for the year ended 31st March, 2023.

(*G-II, May, 2023*) (*10 Marks*)

## Question 83

H Ltd. acquired 15000 shares in S Ltd. for ₹ 1,55,000 on July 1, 2022.

The Balance sheet of the two companies as on 31st March, 2023 were as follows:

| | **H Ltd.**<br>**₹** | **S Ltd.**<br>**₹** |
|---|---|---|
| **Equity and Liabilities:** | | |
| Equity Share Capital | 9,00,000 | 2,50,000 |
| (Fully paid shares of ₹10each) | | |
| General Reserve | 1,60,000 | .40,000 |
| Surplus i.e., Balance in Statement of Profit and Loss | 80,000 | 25,000 |
| Bills Payable | 40,000 | 20,000 |
| Trade Creditors | 50,000 | 30,000 |
| **Total** | **12,30,000** | **3,65,000** |
| **Assets** | | |
| Machinery | 7,00,000 | 1,50,000 |
| Furniture | 1,00,000 | 70,000 |
| Investment in Equity Shares of S Ltd. | 1,55,000 | - |

| | H Ltd. ₹ | S Ltd. ₹ |
|---|---|---|
| Stock-in-Trade | 1,00,000 | 50,000 |
| Trade Debtors | 60,000 | 35,000 |
| Bills Receivable | 25,000 | 20,000 |
| Cash at 'Bank | 90,000 | 40,000 |
| **Total** | **12,30,000** | **3,65,000** |

The following additional information is provided to you :

(i) General reserve appearing in the Balance Sheet of S Ltd. remained unchanged since 31st March, 2022.

(ii) Profit earned by S Ltd. for the year ended 31st March, 2023 amounted to ₹20,000.

(iii) H Ltd. sold goods to S Ltd. costing ₹ 8,000 for ₹ 10,000, 25% of these goods remained unsold with S Ltd. on 31st March, 2023.

(iv) Creditors of S Ltd. include ₹4000 due to H Ltd. on account of these goods.

(v) Out of Bills payable issued by S Ltd. ₹15,000 are those which, have been accepted in favour of H Ltd. Out of these, H Ltd. had endorsed by 31st March, 2023, ₹ 8000 worth of bills receivable in favour of its creditors.

You are required' to draw a consolidated Balance Sheet as on 31st March, 2023.

(*G-II, May, 2023*) (*10 Marks*)

CHAPTER 24

# Accounting Standard 23 Accounting for Investments in Associates in Consolidated Financial Statements

**Question 1**

*A Ltd. acquire 45% of B Ltd. shares on April 01, 20X1, the price paid was ₹ 15,00,000. Following are the extracts of balance sheet of B Ltd. as of 1 April 20X1:*

| | |
|---|---|
| *Paid up Equity Share Capital* | *₹ 10,00,000* |
| *Securities Premium* | *₹ 1,00,000* |
| *Reserve & Surplus* | *₹ 5,00,000* |

*B Ltd. has reported net profits of ₹ 3,00,000 and paid dividends of ₹ 1,00,000 for the year ended 31 March 20X2. Calculate the amount at which the investment in B Ltd. should be shown in the consolidated balance sheet of A Ltd. as on March 31, 20X2.*

(*Source: Illustration 1, Study Material*)

**Answer**

**Calculation of Goodwill/Capital Reserve under Equity Method**

| **Particulars** | | ₹ | ₹ |
|---|---|---|---|
| Investment in B Ltd. | (A) | | 15,00,000 |
| Equity Shares | | 10,00,000 | |
| Security Premium | | 1,00,000 | |
| Reserves & Surplus | | 5,00,000 | |
| Net Assets | | 16,00,000 | |
| 45% of Net Asset | (B) | | 7,20,000 |
| Goodwill (A-B) | | | 7,80,000 |

**Calculation of Carrying Amount of Investment in the year ended on 31st March, 20X2**

| **Particulars** | ₹ |
|---|---|
| **Investment in Associate as per AS 23:** | |
| Share of Net Assets on 1 April 20X1 | 7,20,000 |
| *Add*: Goodwill | 7,80,000 |
| Cost of Investment | 15,00,000 |
| *Add:* Profit during the year (3,00,000 x 45%) | 1,35,000 |
| *Less*: Dividend paid (1,00,000 x 45%) | (45,000) |
| Carrying Amount of Investment | 15,90,000 |

## Question 2

*A Ltd. acquired 40% share in B Ltd. on April 01, 20X1 for ₹ 10 lacs. On that date B Ltd. had 1,00,000 equity shares of ₹ 10 each fully paid and accumulated profits of ₹ 2,00,000. During the year 20X1-20X2, B Ltd. suffered a loss of ₹ 10,00,000; during 20X2-20X3 loss of ₹ 12,50,000 and during 20X3-20X4 again a loss of ₹ 5,00,000. Show the extract of consolidated balance sheet of A Ltd. on all the four dates recording the above events.*

(*Source: Illustration 2, Study Material*)

**Answer**

**Calculation of Goodwill/Capital Reserve under Equity Method**

| Particulars | ₹ |
|---|---|
| Equity Shares | 10,00,000 |
| Reserves & Surplus | 2,00,000 |
| Net Assets | 12,00,000 |
| 40% share of Net Assets | 4,80,000 |
| *Less*: Cost of Investment | (10,00,000) |
| Goodwill | 5,20,000 |

**Consolidated Balance Sheet (Extract) as on April 01, 20X1: ASSETS**

| Investment in Associate as per AS 23 | ₹ | ₹ |
|---|---|---|
| Share of Net Assets on April 1 | 4,80,000 | |
| *Add*: Goodwill | 5,20,000 | 10,00,000 |

**Calculation of Carrying Amount of Investment as at 31 March 20X2:**

| Investment in Associate as per AS 23 | ₹ |
|---|---|
| Share of Net Assets on 1 April, 20X1 | 4,80,000 |
| *Add*: Goodwill | 5,20,000 |
| Cost of Investment | 10,00,000 |
| *Less*: Loss for the year (10,00,000 x 40%) | (4,00,000) |
| Carrying Amount of Investment | 6,00,000 |

**Consolidated Balance Sheet (Extract) as on March 31, 20X2: ASSETS**

| Investment in Associate as per AS 23 | ₹ | ₹ |
|---|---|---|
| Share of Net Assets on 1 April, 20X1 | 4,80,000 | |
| Less: Share of Loss as above | (4,00,000) | |
| | 80,000 | |
| *Add*: Goodwill | 5,20,000 | 6,00,000 |

**Calculation of Carrying Amount of Investment as at 31 March 20X3:**

| Investment in Associate as per AS 23 | ₹ |
|---|---|
| Carrying Amount of Investment as on 31 March 20X2 | 6,00,000 |
| *Less*: Loss for the year (12,50,000 x 40%) | (5,00,000) |
| Carrying Amount of Investment | 1,00,000 |

**Consolidated Balance Sheet (Extract) as on March 31, 20X3: ASSETS**

| Investment in Associate as per AS 23 | ₹ | ₹ |
|---|---|---|
| Share of Net Assets on 1 April, 20X1 | 4,80,000 | |
| *Less*: Share of Loss as above (₹4,00,000 +₹ 5,00,000) | (4,20,000) | |
| *Add*: Goodwill | | 1,00,000 |

**Calculation of Carrying Amount of Investment as at 31 March 20X4:**

| **Investment in Associate as per AS 23** | ₹ |
|---|---|
| Carrying Amount of Investment | 1,00,000 |
| *Less*: Loss for the year (5,00,000 x 40% = 2,00,000, restricted to Carrying amount of Investment in B Ltd.) - refer note below | |
| Carrying Amount of Investment | |

**Consolidated Balance Sheet (Extract) as on March 31, 20X4: ASSETS**

| **Investment in Associate as per AS 23** | ₹ |
|---|---|
| Investment in B Ltd. | - |

- If, under the equity method, an investor's share of losses of an associate equals or exceeds the carrying amount of the investment, the investor ordinarily discontinues recognising its share of further losses and the investment is reported at nil value. Additional losses are provided for to the extent that the investor has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the investor has guaranteed or to which the investor is otherwise committed. If the associate subsequently reports profits, the investor resumes including its share of those profits only after its share of the profits equals the share of net losses that have not been recognised.
- As far as possible the reporting date of the financial statements should be same for consolidated financial statement. If practically it is not possible to draw up the financial statements of one or more enterprise to such date and, accordingly, those financial statements are drawn up to reporting dates different from the reporting date of the investor, adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the consolidated financial statements. In any case, the difference between reporting dates of the concern and consolidated financial statement should not be more than six months.
- Accounting policies followed in the preparation of the financial statements of the investor, investee and consolidated financial statement should be uniform for like transactions and other events in similar circumstances.

  If accounting policies followed by different enterprises in the group are not uniform, then adjustments should be made in the items of the individual financial statements to bring it in line with the accounting policy of the consolidated statement.
- The carrying amount of investment in an associate should be reduced to recognise a decline, other than temporary, in the value of the investment, such reduction being determined and made for each investment individually.

## Question 3

*Describe the cases when AS 23 does not allow the use of equity method of accounting?*

Answer

Equity method of accounting is to be followed by all the enterprises having significant influence on their associates except in the following cases:

(a) Control is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future. The term 'Near Future' is explained with AS 21.

Or;

(b) It operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the investor. In both the above cases, investment of investor in the share of the investee is treated as investment according to AS 13.

## Question 4

*When is an investor required to discontinue the use of the equity method of accounting?*

**Answer**

An investor should discontinue the use of the equity method from the date that:

(a) It ceases to have significant influence in an associate but retains, either in whole or in part, its investment.

(b) The use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.

From the date of discontinuing the use of the equity method, investments in such associates should be accounted for in accordance with AS 13, Accounting for Investments. For this purpose, the carrying amount of the investment at that date should be regarded as cost thereafter.

## Question 5

*Bright Ltd. acquired 30% of East India Ltd. shares for ₹ 2,00,000 on 01-06-20X1. By such an acquisition Bright can exercise significant influence over East India Ltd. During the financial year ending on 31-03-20X1 East India earned profits ₹ 80,000 and declared a dividend of ₹ 50,000 on 12-08-20X1. East India reported earnings of ₹ 3,00,000 for the financial year ending on 31-03-20X2 (assume profits to accrue evenly) and declared dividends of ₹ 60,000 on 12-06-20X2.*

*Calculate the carrying amount of investment in:*

*(i) Separate financial statements of Bright Ltd. as on 31-03-20X2;*

*(ii) Consolidated financial statements of Bright Ltd.; as on 31-03-20X2;*

*(iii) What will be the carrying amount as on 30-06-20X2 in consolidated financial statements?*

**Answer**

**(i) Carrying amount of investment in Separate Financial Statement of Bright Ltd. as on 31.03.20X2**

| | ₹ |
|---|---|
| Amount paid for investment in Associate (on 1.06.20X1) | 2,00,000 |
| *Less*: Pre-acquisition dividend (₹ 50,000 x 30%) | (15,000) |
| Carrying amount as on 31.3.20X2 as per AS 13 | 1,85,000 |

**(ii) Carrying amount of investment in Consolidated Financial Statements of Bright Ltd. as on 31.3.20X2 as per AS 23**

| | ₹ |
|---|---|
| Carrying amount as per separate financial statements | 1,85,000 |
| *Add*: Proportionate share of 10-month profit of | |
| Investee as per equity method (30% of ₹ 3,00,000 x 10/12) | 75,000 |
| Carrying amount as on 31.3.20X2 | 2,60,000 |

**(iii) Carrying amount of investment in Consolidated Financial Statement of Bright Ltd. as on 30.6.20X2 as per AS 23**

| | ₹ |
|---|---|
| Carrying amount as on 31.3.20X2 | 2,60,000 |
| *Less*: Dividend received (₹ 60,000 x 30%) | (18,000) |
| Carrying amount as on 30.6.20X2 | 2,42,000 |

## Question 6

*A Ltd. acquired 25% of shares in B Ltd. as on 31.3.20X1 for ₹ 3 lakhs. The Balance Sheet of B Ltd. as on 31.3.20X1 is given below:*

| | ₹ |
|---|---|
| *Share Capital* | *5,00,000* |
| *Reserves and Surplus* | *5,00,000* |
| | *10,00,000* |
| *Fixed Assets* | *5,00,000* |
| *Investments* | *2,00,000* |
| *II. Current Assets* | *3,00,000* |
| | *10,00,000* |

*During the year ended 31.3.20X2 the following are the additional information available:*

*(i) A Ltd. received dividend from B Ltd., for the year ended 31.3.20X1 at 40% from the Reserves.*

*(ii) B Ltd., made a profit after tax of ₹ 7 lakhs for the year ended 31.3.20X2.*

*(iii) B Ltd., declared a dividend @ 50% for the year ended 31.3.20X2 on 30.4.20X2.*

*A Ltd. is preparing Consolidated Financial Statements in accordance with AS 21 for its various subsidiaries. Calculate:*

*(i) Goodwill if any on acquisition of B Ltd.'s shares.*

*(ii) How A Ltd., will reflect the value of investment in B Ltd., in the Consolidated Financial Statements?*

*(iii) How the dividend received from B Ltd. will be shown in the Consolidated Financial Statements?*

**Answer**

In terms of AS 23, B Ltd. will be considered as an associate company of A Ltd. as shares acquired represent to more than 20%.

**(i) Calculation of Goodwill** (*₹ in lakhs)*

| | |
|---|---|
| Amount paid towards acquisition of stake in B Ltd. | 3.00 |
| Less: Pre-acquisition dividend (₹ 5,00,000 x 40% x 25%) | 0.50 |
| Cost of Investment in B Ltd. | 2.50 |
| *Less:* Share in the value of Equity of B Ltd. as at the date of investment [25% of ₹ 10 lakhs (₹ 5 lakhs + ₹ 5 lakhs)] | (2.50) |
| Goodwill | NIL |

**(ii) A Ltd.**

**Consolidated Profit and Loss Account for the year ended 31st March, 20X2 (An extract)**

| | | ***₹ in lakhs*** |
|---|---|---|
| Other income: | | |
| Share of profits in B Ltd. | | 1.75 |
| Pre-acquisition Dividend received from | | |
| B Ltd. | 0.50 | |
| Transfer to investment A/c | (0.50) | Nil |

**(iii) A Ltd.**

**Consolidated Balance Sheet as on 31.3.20X2 (An extract)**

| | | ***₹ in lakhs*** |
|---|---|---|
| Non-current investments | | |
| Investment in B Ltd. | | |
| Cost of Investment in B Ltd. | 2.50 | |
| Share of profit for year 20X1 – 20X2 | 1.75 | |
| | 4.25 | |
| *Add*: Goodwill | NIL | 4.25 |

**Working Notes:**

1. Pre-acquisition dividend received from B Ltd. amounting to ₹ 0.50 lakhs will be reduced from investment value in the books of A Ltd.
2. B Ltd. made a profit of ₹ 7 lakhs for the year ended 31st March, 20X2. A Ltd.'s share in the profits of ₹ 7 lakhs is ₹ 1.75 lakhs. Investment in B Ltd. will be increased by ₹ 1.75 lakhs and consolidated profit and loss account of A Ltd. will be credited with ₹ 1.75 lakhs in the consolidated financial statement of A Ltd.
3. Dividend declared on 30th April, 20X2 will not be recognized in the consolidated financial statement of A Ltd.